BEYOND THE GLOBAL HEALTH CRISIS

Marcus & Millichap

MARKET REPORT *New Haven-Fairfield County Region* 2H/20

Broader Reopening Phase Continues Employment Recovery; Investment Sales Begin to Rebuild Momentum

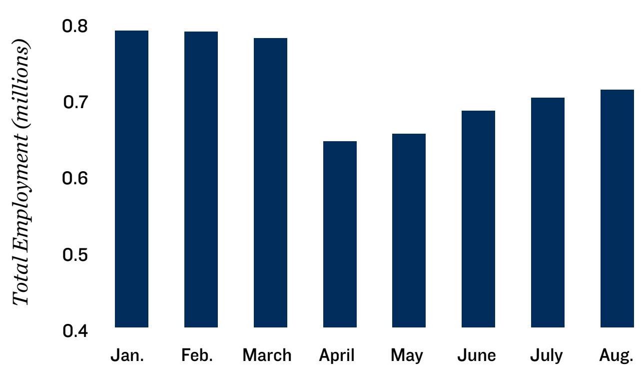
Residential shift could help in job restoration. The health crisis combined with acute population density may have pushed 16,000 New Yorkers to Connecticut between March and June. While some of these individuals are simply spending more time in their second homes, others will be new to the area. This trend, aided by remote work options that will likely be scaled back in 2021, does not undo eight years of negative net migration but could aid in the near-term job recovery. About 46 percent of the 145,300 jobs initially lost across the two-county region have been restored through August, bringing the unemployment rate down to 8.4 percent, on par with the national level. As expected, staff cuts were most prevalent in the leisure and hospitality sector as health precautions limited foot traffic at bars, restaurants and hotels. As retail restrictions abate, spending by a greater number of local consumers should aid in rehiring in some sectors.

Fairfield County development expands space options for renters. The largest share of springtime relocations from New York moved to Fairfield County, a natural destination given the region's proximity to the city. The county has also been the more common target for developers in recent years compared with New Haven County, resulting in a greater supply of newer space for prospective residents and commercial tenants. The new supply pressure has, however, weighed more on fundamentals relative to New Haven County, particularly in the denser environments of Stamford and Norwalk. Reflecting the desire for increased space, office and apartment vacancies were lower in the suburbs, a recent common trend.

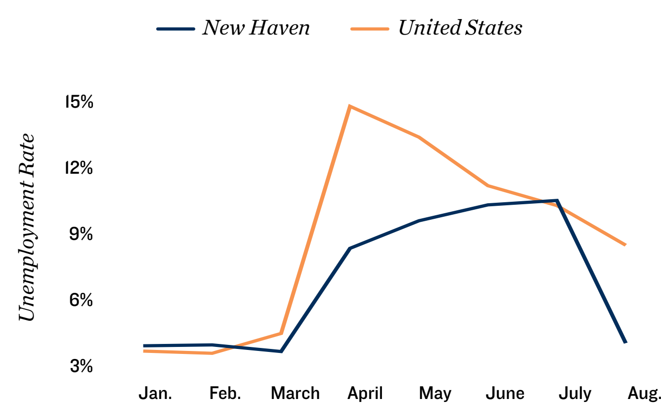
Lower density in New Haven benefits resident health and real estate fundamentals. Limited construction has helped New Haven County vacancies remain below the regional average for most major property types. Tighter availability paired with smaller inventories have also aided apartments and office rent growth. This is particularly true of properties in the lower-density towns surrounding the city of New Haven. The county as a whole experienced less exposure to COVID-19 than areas to the south, and all of Connecticut is now in phase three of reopening, with nearly all businesses permitted to operate. Capacity restrictions are above 50 percent in some cases, ahead of other major Northeast markets. These conditions may prompt some residents who needed to be closer to New York for professional or personal reasons to move up the coast.

Region records signs of investment sales recovery. The trading of retail assets topped a reduced sales pipeline in the second quarter as the pandemic complicated the transaction process and hamstrung the local economy. Preliminary third quarter data suggests accelerating multifamily and industrial property sales velocity, but storefront and office properties continue to face uncertainty surrounding the full impact of closures and displaced working. While competitive advantages in sales price and yield continued to draw some New York-based groups, local investors dominated the marketplace during the peak of the health crisis. These buyers focused more on New Haven County, where the concentration of healthcare and education employment faces less impact from the pandemic.

2020 Employment Trends

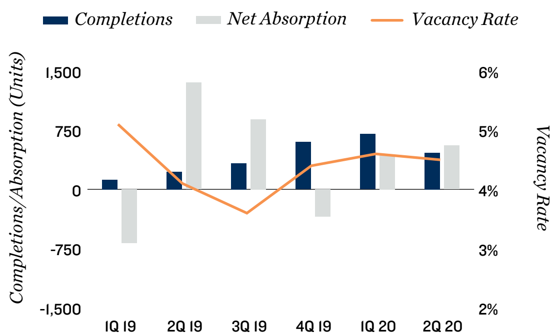


2020 Unemployment Rate Trends

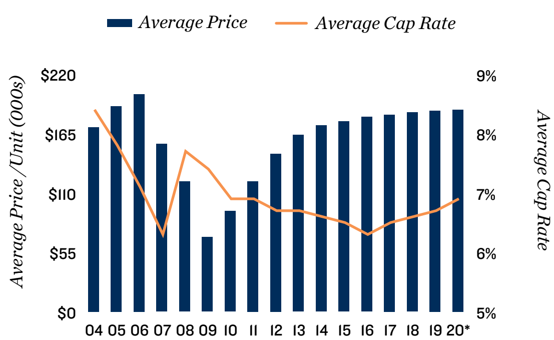


Source: BLS

Apartment Completions and Absorption



Apartment Price and Cap Rate Trends



** Through second quarter*

Sources: Real Page Inc.; CoStar Group, Inc.; Real Capital Analytics

APARTMENT

Fairfield County Welcomed the Most New Supply as Investment Shifted to New Haven County

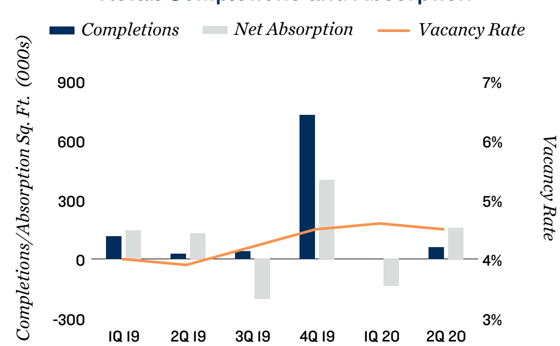
- Approximately 460 units were delivered from April to June, exceeding the trailing-five-year quarterly average by about 70 rentals. Openings were concentrated in Fairfield County, which had about 380 new apartments.
- The region's vacancy rate in June of 4.5 percent was down 10 basis points quarter over quarter but up 40 basis points on an annual basis. Since March availability has climbed in the city of New Haven but contracted elsewhere.
- A nominal dip in the average effective rent between March and June to a monthly rate of to $1,857 extends the annual decrease to 1.1 percent. Rates for the second quarter dropped in urban environments but appreciated in less dense areas.
- Sales velocity contracted by about one-third between the first and second quarters of 2020 as rental income uncertainty slowed decision making. The bulk of trades were of sub-20-door Class B/C New Haven County apartments. One Class A facility in Norwalk also changed hands for a sale price over $15 million.
- The average sale price and cap rate for assets traded over the 12 months ended in June both rose annually, reflecting slightly greater risk expectations among higher-quality space. The per unit price was $186,900, with a mean yield of 6.9 percent.

RETAIL

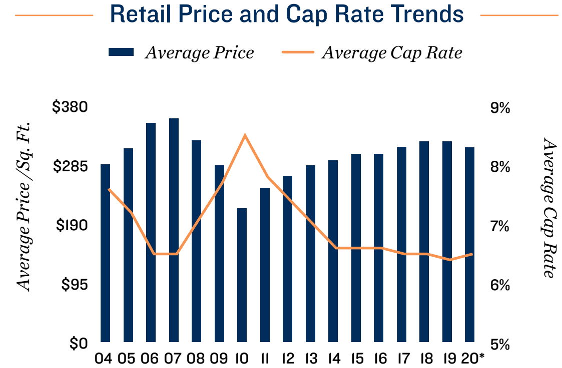
New Haven County Vacancy and Rent Values Softened as Investors Showed Preference for Suburban Assets

- A modest 60,000 square feet of retail space opened in the market in the first half of the year, compared with about 140,000 square feet during the same period in 2019. Hartford HealthCare's built-to-suit Cheshire location was the largest delivery.
- A 10-basis-point dip in vacancy during the second quarter to 4.5 percent did not offset the 70-basis-point climb posted over the prior nine months. Availability in New Haven County exceeded Fairfield County's level by 110 basis points in June.
- Mandated closures and capacity restrictions did not deter a 2.3 percent increase in the average asking rent between March and June to $21.57 per square foot. The advance was driven by less-vacant Fairfield County as rates for available space in New Haven County decreased quarter over quarter.
- Second quarter transaction velocity dropped by less than one-third relative to the first three months of the year as the investment focus shifted to New Haven suburbs.
- The average sale price for the year ended in June fell 3 percent annually to $312 per square foot, driven by a steeper drop among multi-tenant space. Over the 12-month period, single-tenant properties changed hands with an average cap rate of 6.0 percent while the average yield for multi-tenant assets was 7.1 percent.

Retail Completions and Absorption



Retail Price and Cap Rate Trends



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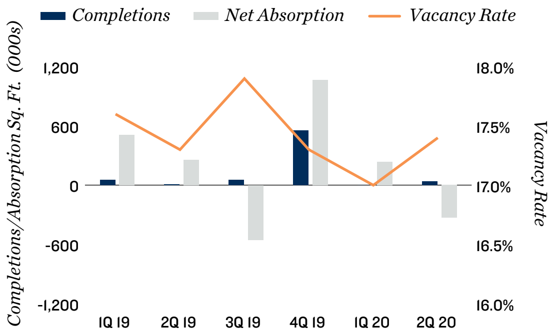
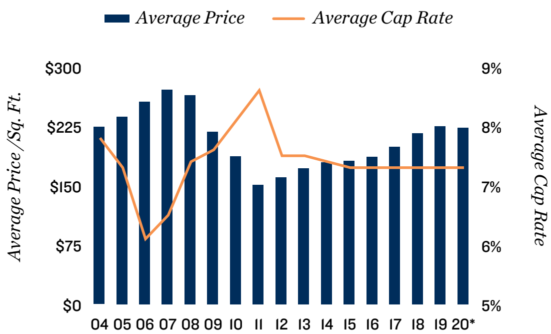
Office Completions and Absorption



Office Price and Cap Rate Trends



** Through second quarter*

Sources: CoStar Group, Inc.; Real Capital Analytics

OFFICE

Central New Haven's Vacancy Jumped as Investors Targeted Offices With Medical or Residential Components

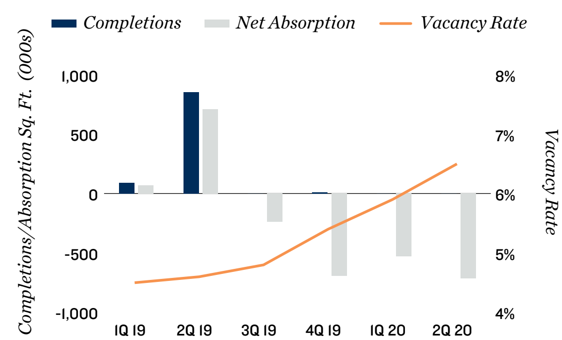
- Less than 40,000 square feet opened in the six months following the final quarter of 2019, when over 550,000 square feet was delivered. The pace of arrivals picked up in the third quarter with an additional 300,000 square feet still underway.
- Availability rose 40 basis points between March and June to 17.4 percent, up 10 basis points from 12 months prior. The regional change was driven by a jump in vacancy for Class A offices in New Haven County, which was 23.3 percent at midyear.
- The average asking rent for available space fell 1.9 percent in the second quarter to $28.62 per square foot, 3.3 percent above a year earlier. Rates dropped in Fairfield County, where the average is about $10 above the New Haven measure.
- Office transactions have taken a notable step back in 2020 as the health crisis complicated all aspects of the sales process. The majority of second quarter sales comprised either medical office properties or live/work mixed-use facilities in both urban and suburban settings of New Haven County.
- Fewer trades limited the impact on annual sales trends, as the trailing-12-month average sale price for June was up 1 percent year over year to $223 per square foot. The average cap rate remained flat at 7.3 percent in that span.

INDUSTRIAL

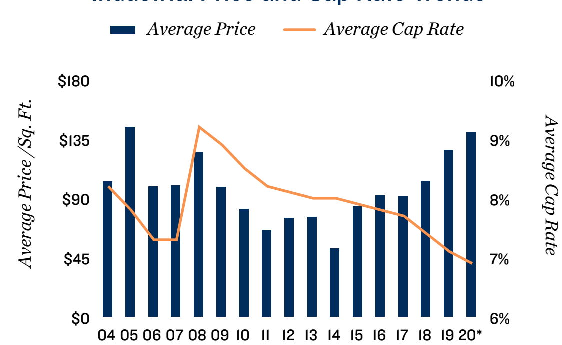
Potential Wave of Development Under Proposal; After Blip, Investor Demand Begins to Recover

- Minimal supply was added in the first half of 2020. A 45,000-square-foot Norwalk warehouse constituted the largest project currently underway. Another 1.8 million square feet is under proposal with target deliveries extending into 2022.
- A net 715,000 square feet was vacated in the second quarter, pushing the vacancy rate up 60 basis points to 6.5 percent, its highest level in nearly four years. Availability jumped the most, up 130 basis points to 7.1 percent, in Fairfield County.
- Despite minimal new supply pressure, the average asking rent fell to $6.90 per square foot in June, a 4.3 percent contraction year over year. Older assets returning to the pool of marketed space contributed the decline.
- Sales activity withdrew notably in the second quarter compared with the first three months of the year, although preliminary data from the third quarter suggests a return to 2019 quarterly velocity. Trades posted from April through June were predominantly for sub-100,000-square-foot Class C New Haven County warehouses.
- The average sale price for properties traded between July of 2019 and June of 2020 was $140 per square foot, well above the average from the previous 12-month period. The average cap rate for the same span was 6.9 percent.

Industrial Completions and Absorption



Industrial Price and Cap Rate Trends



** Through second quarter*

Sources: CoStar Group, Inc.; Real Capital Analytics

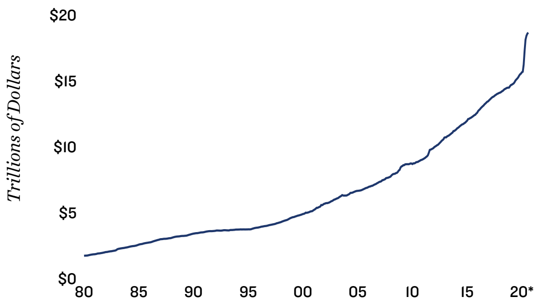
Marcus & Millichap

CAPITAL MARKETS

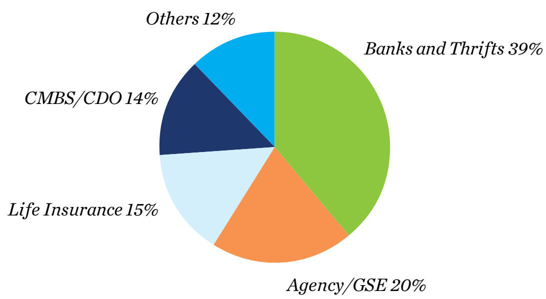
By TONY SOLOMON, Senior Vice President, Marcus & Millichap Capital Corporation

- **The capital markets are thawing relative to the height of the crisis.** Most lenders have adapted to dispersed working, and more information on the economic damage of the pandemic is affording buyers, sellers, and lenders risk and price clarity for large swaths of the commercial real estate sector. Both property performance and location can impact financing as some areas of the country outperform and the pace of recovery remains in doubt for others. Capital is readily available for assets that perform on or near par with pre-crisis levels, especially industrial assets, which buyers and lenders see as a safe part of their portfolios. Single-tenant retail with national credit tenants are also heavily favored by lenders, followed by grocery-anchored multi-tenant properties. Apartment rent rolls are more heavily examined, though financing remains available from the agencies and banks. Loans are more readily accessible for suburban office, while core buildings are more difficult to leverage. Some lenders continue to operate in the hospitality space, but obtaining financing is challenging.
- **Loan-to-value ratios were already declining prior to the pandemic and average 60 percent.** Freddie Mac is offering rates in the high-2 percent to high-3 percent range for seven-year terms. Debt service coverage is approximately 1.35 times. Life insurance companies will finance below 3 percent for apartments in some cases, and peak at 4 percent for retail. CMBS loans are available, though strict criteria makes deals more difficult to find. Rates bottom in the low-3 percent range for apartment and industrial and rise to 4 percent for office.

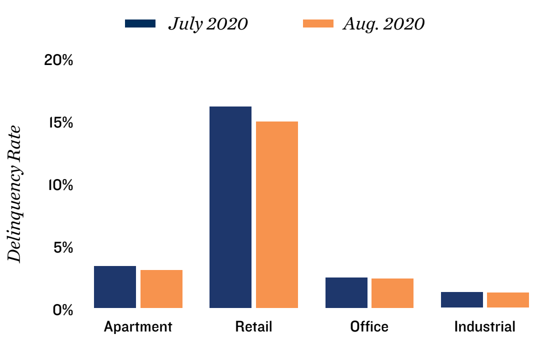
Fed Sharply Increases Money Supply During Health Crisis



Total Outstanding Mortgage Debt**



30+ Day CMBS Delinquency Rate



* Through August

** As of second quarter

Sources: Federal Reserve; Mortgage Bankers Association; Trepp

Prepared and edited by

Cody Young

Research Analyst | Research Services

For information on national commercial real estate trends, contact:

John Chang

Senior Vice President, National Director | Research Services Division

Tel: (602) 707-9700 | john.chang@marcusmillichap.com

National Multi Housing Group

John Sebree

Senior Vice President, National Director | National Multi Housing Group

Tel: (312) 327-5417 | john.sebree@marcusmillichap.com

National Retail Division

Daniel Taub

Senior Vice President, National Director | Retail Division

Tel: (212) 430-5100 | daniel.taub@marcusmillichap.com

Office and Industrial Properties Division

Alan L. Pontius

Senior Vice President, National Director | Office and Industrial Properties Division

Tel: (415) 963-3000 | al.pontius@marcusmillichap.com

New Haven Office:

John Krueger

Vice President/Regional Manager

Tel: (203) 672-3300 | john.krueger@marcusmillichap.com

265 Church Street

Suite 210

New Haven, CT 06510

Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Federal Reserve; Mortgage Bankers Association; Real Capital Analytics; RealPage, Inc.; Trepp; U.S. Postal Service

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