How the real estate industry is pivoting to remain relevant

Learn the top ways your firm can tackle disruption now and in the future

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To survive the pandemic, the real estate industry must anticipate and adapt to change.

The prolonged COVID-19 pandemic has strongly impacted the industry, from construction and brokerage operations to the marketing of listings and property closings. The pandemic has exposed the pitfalls of failing to invest in technology. The move toward remote work has prompted tenants to reduce their leased space or get out of buildings entirely. At the same time, the labor shortage that has been growing worse over the past decade is starting to reach its peak.

Real estate, it seems, is getting hit from all sides. The only way out is to adapt to these changes.

In this e-book, we explore the top ways real estate firms can tackle disruption and ensure the longevity of their businesses. You'll learn how the real estate industry can:

- Attract and retain tenants in a changing world
- Attract and retain employees during the labor shortage
- Use technology to adapt to change and remain relevant
- Reevaluate portfolios to stay ahead of the market
- Plan for an uncertain future

How to adapt to changing tenant expectations

The uncertainty of the COVID-19 pandemic presents special challenges in working with existing tenants of leased space. Building management professionals and tenants themselves have stepped up to outfit properties to support the safety, comfort and overall well-being of their occupants, whether they are workers, customers or short-term visitors.

These days, a strategic focus on retaining tenants and attracting new ones is paramount.

Renegotiating lease terms

As tenants review their long-term space needs and seek changes to their real estate footprint, flexibility has become the norm.

With in-office head counts expected to be reduced for the foreseeable future, it's important to stay open to renegotiating lease terms early to satisfy tenants who might otherwise look to cut and run.

The option to sublet their existing space, even for a limited period, has become appealing, especially for tenants unsure of their longer-term space needs.

Existing office tenants with traditional three- to five-year leases are having a much easier time shortening those commitments than they have in the past. In the retail sector, investors have reason for optimism. Net new-store openings exceeded closings in the fourth quarter of 2021, and leasing is showing signs of improvement.

Sale-leaseback option

Another option gaining traction is the sale-leaseback. A struggling business can improve its cash position by selling its owned real estate while retaining the right to use the property through a long-term lease. Investors seeking quality, income-producing property with a tenant willing to sign a long-term lease may find this an attractive opportunity. These commitments are usually 10-15 years.

65% of survey respondents reported an increase in tenants who received rent concessions.

46% reported an increase in leasing transactions in suburban areas versus the central business district.

69% reported an increase in companies leasing or moving into offices with smaller square footage due to working from home.

63% reported an increase in short-term office leases.

Source: "Commercial Real Estate Trends & Outlook January 2021 Quarterly Market Survey" by the National Association of Realtors.

What's influencing office and retail recovery

The principal factors needed for office and retail recovery fall into three main areas:

- **Striking a balance between owner and tenant needs:** Property owners are currently focused on tenant retention at all costs, but they also must satisfy investors.
- **Offering plentiful amenities and concessions:** Owners and building managers will continue to be generous with concessions and keep rent hikes minimal in the next few years, until tenant demand notably increases. On-demand concierge and delivery services that sprang up in the pandemic are likely here to stay.
- **Remaining patient:** Organic business growth may not be sufficient to generate absorption for current vacancies. In the absence of major industry shifts or a new industry entering a local market, population growth will be necessary to absorb the oversupply and bring down vacancy rates, especially in large urban centers.

Digital adoption, accelerated by the pandemic, has had enormous consequences for work life, consumer habits and the spaces people occupy.

And paying attention to a building's carbon footprint has become an essential component of any real estate footprint conversation. Higher green building standards are not only good for the environment — they've become essential for business. The investor community's expectations are changing along with the public when it comes to sustainable practices that will continue to matter long after the pandemic has subsided.

How to use game-changing tech tools

Technology's potential to transform commercial real estate practices has been evident for some time, but COVID-19 was the trigger to get many slower adapters on board quickly.

Developers need to know what local or even hyperlocal needs are when they make plans to bring new products to the market. How do those interests fit with changing market demands caused by external factors, whether a pandemic or the Great Recession of 2008-09? What does the zoning allow for?

While tech tools alone won't provide all the answers you need when identifying, designing, raising funds and building out projects, employing a combination of these can provide a smart path forward. Here are technology platforms that can help:

1. Financial forecasting tools

Beyond its value in site selection and construction design parameters, technology can play a pivotal role in evaluating the financials of a project. Think market data and sales comps for a local area. This is equally important to equity investors as debt lenders. Stakeholders need to see that a deal "pencils" and that they'll potentially get an attractive return before they make a commitment.

Financial forecasting tools allow you to customize software to your needs and existing conditions to track costs and revenue, measure cash flow and analyze the profitability of a project from initial proposal to completion.

Replacing Excel files and slide decks with a software solution in the creation of a project's pro forma can be game-changing. Imagine seamlessly projecting net operating income and cash flow through an automated system that factors in expected rental income and operating expenses.

This data at your fingertips will guide decision making for investors and lenders considering whether they'll move forward on your proposal.

Tech trends

56% of respondents believe the pandemic has uncovered shortcomings in their digital capabilities.

80% of respondents have an outdated core system that can't easily incorporate emerging technologies.

48% said their company is planning to increase investment in digital channels over the next year.

Source: "2022 commercial real estate outlook" by Deloitte

2. Parametric architecture tools

Based on algorithmic thinking, parametric architecture is a newer design concept that, along with building information modeling (BIM), can simulate how a proposed building at its earliest inception will affect the behavior of the people around the building or in the neighborhood as a whole. It's much more sophisticated than the digital hologram offered through augmented reality or virtual reality.

Using parametric architecture tools, you can predict well in advance of construction how a design decision could affect the quality of life for residents. It is context-based, adaptive and customizable.

For example, if you build a 30-story apartment building, parametric tools help you show how many floors of parking are needed based on local factors. If 10 floors of parking are added, how does that impact the walkability of the neighborhood? If you put in no parking, but 500 residents come in, have you just made the parking problem in the neighborhood worse?

These questions can be addressed through the tools. The key is finding the right middle ground for the project at hand.

3. Project management tools

When the financials check out and a project is shovel-ready, project management software will keep everything on track at every phase and for all elements off the construction process — from the laying of foundation to going vertical, to the installation of utilities and the final inspections before occupancy. It outlines who needs to be on site and when for each stage.

Tools can also handle job costing to show clearly what the expenses are in real time with each stage and how they track with the given estimates. You get immediate red flags for overruns — think of this as an early warning system. The overall aim is to provide confidence to the people who are bearing all the risk in these projects.

4. Investor portals

The rise of the financial dashboard, well-established in the corporate equities arena, is a boon for investors who may be leery of contributing cash through a real estate partnership without real-time access to financial performance data about the project or fund.

These tools allow asset management firms with a CRM to give investors the full picture instantly of a project or investment that informs their relationship with investors and allows them to have easy access to documents and performance in the cloud at any time.

While the largest developers and asset managers have been the first to incorporate these portals into their business initially, these platforms are on their way to becoming standard at firms across the continuum. Expect to see more smaller developers participating as familiarity grows along with investor expectations for access. Confidence rises with these systems because they're able to ensure the project is following the highest safety standards for encryption, data storage and authentication.

5. Cybersecurity tools

From a cybersecurity standpoint, smart companies are consolidating toward platforms such as Azure and AWS, which offer an additional layer of protection against data breaches. Anytime you move a small project to the cloud, you have to entirely reassess your cybersecurity posture because it takes only one little pinhole in the entire equation for your organization to potentially be exposed.

Today's platforms can offer reasonable assurance that they meet the highest security compliance requirements.

6. Data visualization tools

Firms are adopting data visualization tools like Power BI to give life to their metrics. Users can now confidently access their real estate portfolio to make changes in their allocations in an expedient way, akin to the way people make exchanges with their traditional stock portfolio. The data also helps with tax liability planning and compliance.

The portals can rely on incorporating a variety of metrics, including forecasts for cash-on-cash returns, ESG monitoring like projected energy efficiently and climate resiliency of a project, to empower investors.

The asset management and development firms that take advantage of the vast potential with these tools are in the best position to attract and maintain productive relationships with investors and other partners through ever-changing economic and market conditions.

How to form a successful real estate investment fund

As a developer or asset manager, you know that attracting investors requires attention to a myriad of financial and legal details. Even if you are the best networker and relationship builder in the world, the quality and professionalism of your private placement memorandum (PPM) can make all the difference in launching a successful fund that confers confidence and trust with prospective investors.

These days, some investors are motivated less by maximizing their own financial gain and more by furthering a mission that is embodied by the development itself.

The focus on diversity, equity and inclusion or environmental, social and governance initiatives may be the driving force behind some real estate investment funds, contributing to an increasingly crowded field in the search for equity and debt financing.

Focusing on the structure and content of your PPM is critical to providing reassurance about your strategies regarding your ability to raise money, fund governance and day-to-day management, as well as your total expected spend and projected ROI.

While it's necessary to outline a strong vision for what the building project will look like and the tenant composition, it's not always sufficient. Here are five important elements to remember when creating a real estate investment fund:

1. Provide funding source details

While highlighting any previous experience you have with getting deals done is advisable and helpful, investors in a current project require details about how their funds are being handled during the designated fundraising period. They want to know information such as how that money will be placed two to five years down the road or what the targeted returns are in, say, 5-10 years or more. Be sure equity and debt ratios are spelled out, as well as the funding source for any borrowed money, whether it's traditional commercial financing, mezzanine, PACE or a HUD loan.

Include a letter of intent from any banks you have been approved by, showing the amount of money you can borrow and the approved interest rate. If it's a construction loan you're seeking, you may need to show who is guaranteeing it and the game plan for project stabilization and seeking permanent financing.

In addition you will need to meet a certain equity threshold before you can move forward with obtaining other financing. Otherwise, there is no deal. If you have an anchor investor willing to commit a significant portion of the equity requirement, it will be a lot easier for other investors to get involved. That first investor is critical and also has a strong say in molding the parameters of the project. For at least 80% of potential investments, the biggest hurdle is insufficient equity and cash at the early stages.

2. Factor in shifting space needs and tenant mix

The COVID-19 pandemic has had a strong impact on commercial space needs, so it's important to communicate to investors about lease terms on projects that could involve a repurposing of existing space. These changes are much more likely in the office and retail sectors, since working and shopping behaviors have changed dramatically. Those changes may well have shifted permanently in many cases.

3. Vet your professional team

As you develop a complex fund structure, make sure the professional team of CPAs and attorneys you're working with offers the full complement of skills you need. When you hire generalists, you can run into problems if they lack deep experience involving partnerships, real estate, and tax law when drawing up complex financial agreements.

One of the most common missteps involves the structuring of carried interest or investor/sponsor waterfalls in the operating agreement. When legal documents are written up incorrectly, additional tax liabilities can be created for the parties involved.

The right professional team of CPAs and attorneys will be able to present you with options to help you make the best decisions for your fund structure. For instance, some developers want to be paid the developer fee directly, others want it rolled into the deal, and others want a combination of both. Some have a requirement or option that those fees be invested in their deal, and some have separate asset management fees, property management fees, loan guarantee fees, etc.

4. Pay attention to growth areas

Lately, multifamily buildings are drawing a lot of interest, as are single-family rentals in the investment community. But every market is different, so be sure the vision for a demographic area makes sense. What works in rural Wisconsin probably isn't right in downtown Minneapolis. The deal size, tenant mix, exit value sustainability and potential value added through development, redevelopment, leasing and other items can have a significant impact on investor returns and expectations.

5. Know when the little things are big things

Even when you keep these fundamental criteria in mind when setting up a real estate fund, don't get tripped up by the basics like time management. Pay attention to deadlines for various credit opportunities at the local, state and federal levels.

The always-competitive process of launching a successful real estate investment fund has gotten even more challenging in an environment experiencing dramatic market shifts and a generation of new participants. Be sure you understand the motivation of investors whose definition of ROI may go beyond what they earn for themselves.

How to win the war for talent

Commercial real estate is well-recognized as a jobs generator and major contributor to the nation's economic recovery. In 2021, building development and operations of existing buildings supported 8.5 million jobs and contributed $1.2 trillion to GDP, according to industry trade group NAIOP.

Still, commercial real estate itself is hardly immune to the challenges facing nearly all employers, stemming from the Great Resignation in which millions have voluntarily exited from their jobs since the start of the COVID-19 pandemic. The real estate industry needs to become more agile, tech-proficient and strategic to win the war for talent.

Firms need to think differently about the people they already have on board to focus on retaining them at a time when it's become one of the strongest "buyer's markets" ever for America's workers.

The Great Resignation and the labor shortage meet

- In January 2022, the U.S. had 11.3 million jobs open.
- There are 4.6 million more jobs than there are potential workers — the worst labor shortage since World War II.
- At least 3.6 million workers have quit their jobs each month since April 2021.

Because many real estate development, investment and asset management companies are relatively small operations from a staffing perspective, they may not have to contend with filling a huge number of vacancies like large organizations do, but finding that "needle in a haystack" candidate or two to fill out a team has become especially difficult.

Given the competition for talent, real estate companies need to be more broad-minded and action-oriented than they have in the past to fill positions. Here are key approaches to help you find individuals with the right fit and how to retain them over their career:

1. Adopt strategic hiring practices

- **Get proactive:** It's not enough anymore to post job openings on LinkedIn, Indeed or your own website and expect the right applicants to simply show up. Develop a more sophisticated recruiting strategy for how to look for candidates.
- **Attend networking events:** But don't limit them to the real estate industry. Broaden your contacts in related fields like construction, hospitality and others that may lead you to individuals whose knowledge, skills and abilities can translate to your office's needs and pain points.

- **Reach out to universities:** Find schools that might not have been on your radar to develop a pipeline for entry-level employees. In addition to new graduates, they often have strong alumni networks you can tap into.
- **Stay mindful of generational motivations:** Newer generations eagerly seek to embrace the vision and mission of the company they work for. It's on you to make a compelling case for an individual to join. Make sure you articulate what your company stands for and aspires to be, apart from its financial goals. Employee well-being, social responsibility and diversity initiatives have become paramount for many of today's workers. From the onset, you want to provide interested candidates with a reason they should join and, more important, stay with your organization.
- **Consider pre-hiring assessments:** Help your firm make smarter hiring moves and shorten ramp-up time. Behavioral assessments like Predictive Index®, in particular, can "decode" candidates' motivations and help you determine whether they'll be the right fit.

2. Implement new ways to retain your people

- **Make sure your onboarding process works:** The experience your new hires have as they get up to speed about your company will affect their feelings about the organization — and likely their intentions to stay put for a while. They need details about what it takes to be an effective and productive member of the team. The incoming workforce has a much more transitory mindset about jobs than previous generations, so they need to feel connected to an organization from day one.
- **Develop meaningful, relevant training:** Even a small firm needs to invest in resources that keep employees engaged and growing. Look into LinkedIn Learning and other on-demand online programs, as well as professional trainers, either in-person or online.
- **Keep things flexible:** Be open to a three- or four-day workweek. Giving people the freedom to work remotely or during nontraditional hours is becoming the norm and will surely set you apart from firms that haven't evolved in terms of tech capabilities and their definition of the workday. Be sure to set people up for success in terms of engagement with colleagues and clients.
- **Compensation matters:** Be sure your rewards for performance are exemplary. More than 87% of real estate firms offered merit increases in 2021, with an average raise of 3.4%, according to CEL & Associates. Given the resurgent year for the industry, bonuses were offered at 90.5% of firms, according to CEL, rebounding from 2020, when their prevalence fell to about 25%.

3. Develop career pathing

- **Discuss employees' ideal future career state:** Ensure new hires have a clear understanding about what their role could lead to down the road and how they get there. It's not a promise of a promotion, but rather a path that is available if they achieve and thrive as expected.
- **Listen to your employees' aspirations:** Don't expect they'll fit into neat boxes that your company has laid out in the past. Be prepared to develop roles that fit the strengths and interests of your new hires. Individuals should feel encouraged to express their professional goals.
- **Think of the benefit package more holistically:** Beyond the salary, 401(k) and profit sharing, it's important to recognize work-life balance and the well-being of employees outside of work. Community service projects and philanthropic giving can go a long way in furthering the connectedness of your team members. The value proposition for employees has to align with company mission, vision and values.
- **Grow future leaders:** Bring on people with the potential to grow into leadership roles, and be sure employees understand how that path works.

How to chart a steady course for uncertain times

Planning for the future can seem daunting when so much in the economy — and in real estate — is in flux. And these are particularly unsettled times.

Interest rates are climbing along with median real estate prices. Office space needs are in limbo. Housing shortages are worsening. On the upside, rents have rebounded in most commercial sectors. Demand for land is strong, and retail is in the midst of a reinvention.

But what will it take to repurpose vacant office space, which exceeded 12% at the end of last year and continues to climb? More tax incentives? New lending programs? Other government funding?

Real estate is always adapting to change, which means you need to stay on top of best practices in your field. It may be tempting to shift business strategies when the possibility of a new tax plan or other sweeping legislation looms.

And while it's wise to monitor developments on Capitol Hill and in your own statehouse, it's never a good idea to act precipitously.

Smart decision making is never done reactively. The latest government proposal or stock market volatility can surely provoke an emotional reaction, but that should never be the basis for a business decision.

Meanwhile, a well-thought-out strategy that factors in systemic changes and longer-term trends will always set you up for success.

Several phenomena have emerged lately are already making an impact on real estate investment decisions and will surely grow in importance in the years ahead.

Environmental, social and governance

ESG is becoming a buzzword, but developing and communicating a commitment to social and environmental stewardship is becoming indispensable. No real estate firm can afford to look the other way on issues such as reducing the carbon footprint of their business or their assets. Similarly, climate resiliency needs to be a central discussion point in every real estate project. Extreme weather patterns have enormous implications for all segments of the real estate business.

Real estate investors are starting to ask fund managers what their ESG plans are. They are looking beyond ROI in their decision making. And the last thing you want is to be caught unprepared without an answer. Diminishing or deflecting those concerns related to environmental well-being and the social good is likely to lead to missed opportunities or even a loss of business.

As for the social part of ESG, diversity, equity and inclusion have become guiding principles in all business practices. Companies committed to equitable, inclusive work environments win the war for talent. Shifting mindsets, behaviors and practices doesn't happen overnight. But committing to these values matters at a time when people are more inclined to do business with socially responsible organizations.

Mastering the data

Look at demographic and educational trends more closely for their long-term influence on real estate needs. Software tools exist to capture and analyze information that can guide real estate developer and investor decision making. For example, medical office and research space has been a fast-growing area, but that pace of growth may be out of the sync with the fact that the number of medical researchers coming out of graduate school is slowing.

The shortage of doctors and nurses in many places needs to be recognized in development plans, even when the demand for healthcare services is high. Relevant industry and population data can inform decisions about the tenant pipeline for any proposed real estate project.

Workforce changes

The COVID-19 pandemic upended work as we knew it. It's become clear that the labor force has undergone a seismic shift in two major ways:

1. More have opted out of the workforce than ever. About 10% of people who are able to work are still on the sidelines two years after the onset of the pandemic. Some have felt unsafe about going back to work, particularly in service fields with long hours and low pay. Investors are keeping a close eye on the supply of construction workers as new projects are proposed.
2. Office-based workers who became accustomed to working from home generally prefer to stay there. Having gotten accustomed to working from home offices or in co-working spaces near home, interest in in-office contact has waned along with the appetite for commuting.

No one knows how the office landscape will change in the long run, but what is clear is that you can't rely on pre-pandemic growth and usage expectations.

The path forward for real estate success is building and maintaining strong, trusting relationships with your business network. Bad news in the markets shouldn't get you down. And the worst thing you can do is act in haste. Adopting a flexible mindset — along with the proper research — can help you and your team make the right decisions.

When leadership articulates and executes a strategic vision for your firm, confidence growth and deals can move forward.

Are you ready to tackle disruption?

Wipfli can help you navigate real estate decisions during a time of dramatic market and economic volatility. Our advisors help guide your strategic planning and assess trends that matter most to your business. Making smart investment decisions requires thoughtful, proactive planning, not reactive changes in response to immediate events. We're here to help you and your investors stay on track for the long run.

Discover more about how Wipfli can help you adapt to change in your industry, pivot to remain relevant and ensure the longevity of your business.

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