DBS GROUP

# TREND REPORT 2023

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GENERAL CONTRACTOR

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Looking ahead to 2023, we continue to see pandemic reverberations in commercial construction. Clearly, pandemic-era decisions take much of the blame for today's economic uncertainty, inflationary pressures and supply chain issues. But it also takes credit for movements toward well-being and restoration — themes that carry through the design-build world in diverse sectors.

While economic forecasters predict slowed growth in commercial construction overall in the year ahead, opportunities are still there for the investors, developers and property owners who want to continue building the future and position themselves to maximize ROI as remaining COVID clouds dissipate.

This year's report shows you where you're likely to find those opportunities and how to design and build to make the most of your new or remodeled facilities. But remember, there are exceptions to nearly every rule. So if you have a need or a vision for a commercial property investment of any type, come see us. With our predevelopment and preconstruction services, we can help you find the way — whatever the financial or economic climate.

Chris Walters
CEO and President

# ECONOMISTS PREDICT STAGFLATION

Most economists expect inflationary pressures to linger in the new year, with a recession settling in early 2023. The good news is they don't expect it to last through the year. And though unemployment rates will likely increase somewhat, experts don't expect to see the high levels that traditionally come with economic contraction. Ironically, they also don't expect the increased jobless rate to ease the tight labor market.

While Dodge Data expects those economic factors to slow construction starts, there will still be plentiful opportunities and activity, especially considering that even with less growth, the industry will still see $1.08 trillion in projects this year — many of which are already planned. That's not bad for a year of inflation and recession.

**Economic growth by GDP**

**0%**

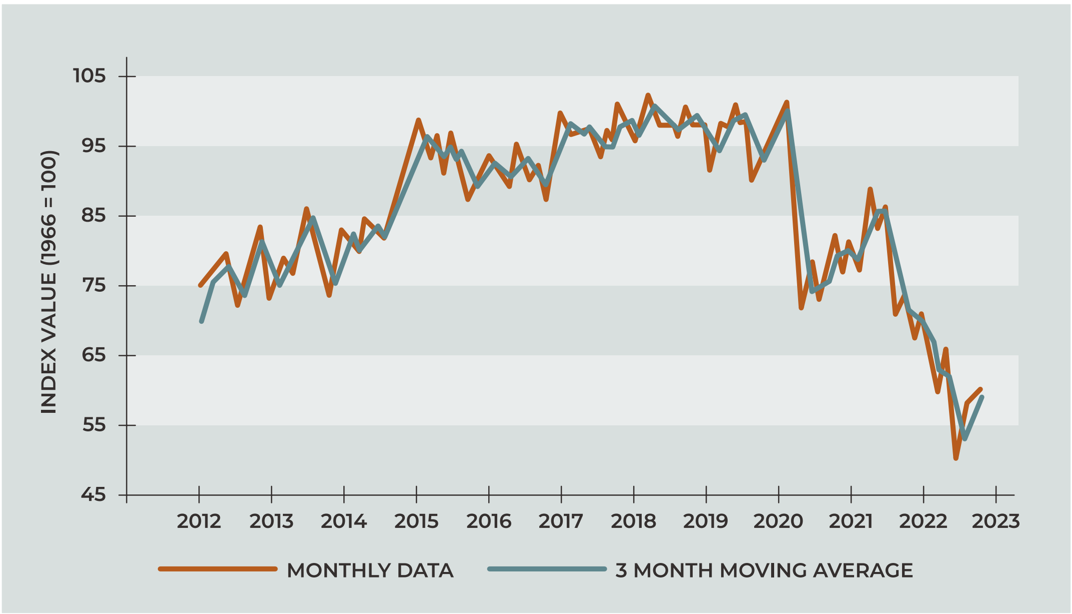
(Source: Conference Board)

**Commercial Construction Starts**

**-3%**

adjusted for inflation
(Source: Dodge Data & Analytics)

## THE INDEX OF CONSUMER SENTIMENT



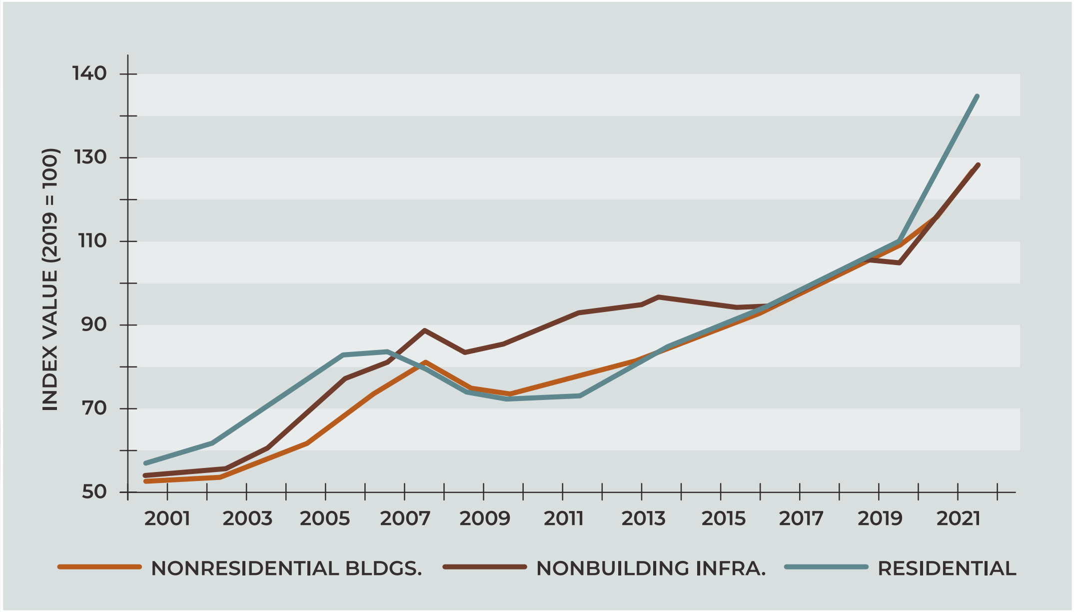

(Source: University of Michigan Consumer Sentiment Survey)

Considering commercial construction projects take 12 to 30 months from the start of design to the ribbon-cutting, many businesses are attempting to time their development pipeline accordingly, assuming economic recovery and growth in 2024.

## CONSUMER CONFIDENCE INDEX


(Source: United States Conference Board)

## CONSTRUCTION ANALYTICS BUILDING COST INDEX CONSTRUCTION INFLATION




(Source: Ed Zarenski)

# FACTORS DRIVING 2023 DESIGN-BUILD TRENDS

**Labor shortage.** With 10 million job openings and only 6 million people unemployed, there's no end in sight to the labor disruption. As a result, more businesses will look to technological improvements and smart initiatives to improve efficiencies and bridge the worker gap.

**Supply chain instability.** A study from SAP reported that business leaders are still struggling with supply chain issues. The challenges are leading U.S. businesses to fend against future disruptions by storing more extensive inventories over longer periods and sourcing more from state, regional and American manufacturers.

**Inflation.** Labor and materials shortages mean short supply and high demand, which equate to higher prices. And while we saw steep inflation rates in 2022 (nearing 8%), Kiplinger expects the slowing economy likely will bring inflation down to 3.2%, and Morningstar head of U.S. economics Preston Caldwell told NextAdvisor he expects it will come in under 2% in 2023.

**The economy.** More than half of business executives participating in the American Institute of CPAs and Certified Investment Management Analysts' economic outlook survey said the U.S. economy is already in a recession. Many saw it coming months ago and built cash reserves and paid down debt, and today, still with their eye on the long game, are strategizing, innovating and adapting for post-recession times. In fact, according to the AICPA and CIMA study, nearly half (47%) are planning to expand their companies.

**Sustainability.** Driven by growing consumer demand and an inclination to reduce expenses, more companies are embracing green practices. Sustainability practices, from power-reducing building systems (e.g., HVAC) to recycling and reusing, offer businesses a number of financial incentives, including tax deductions and credits and government subsidies through grants and financing programs, while also saving operating costs. Plus, while affordability and quality remain top priorities, an independent study commissioned by Smartest Energy found that four out of five consumers say they're more likely to purchase from green-minded companies, and 71% are actively buying more environmentally-friendly products than they were five years ago. That number is expected to increase to 81% in the next five years.

**Restoration.** An extension of sustainability, restoration is an important theme we see driving design this year. Still recovering from — and living with — the pandemic, consumers are looking for equilibrium, holistic wellness and a return to nature.

**Location.** The migration to nonurban areas will continue but at a slowing pace through the next two years, according to the Urban Land Institute, as people continue seeking lower taxes and more affordable housing options. But the pace will be tempered by the increasing number of businesses requiring remote workers to return to the office at least a couple days a week.

We see

**7 dominant factors**

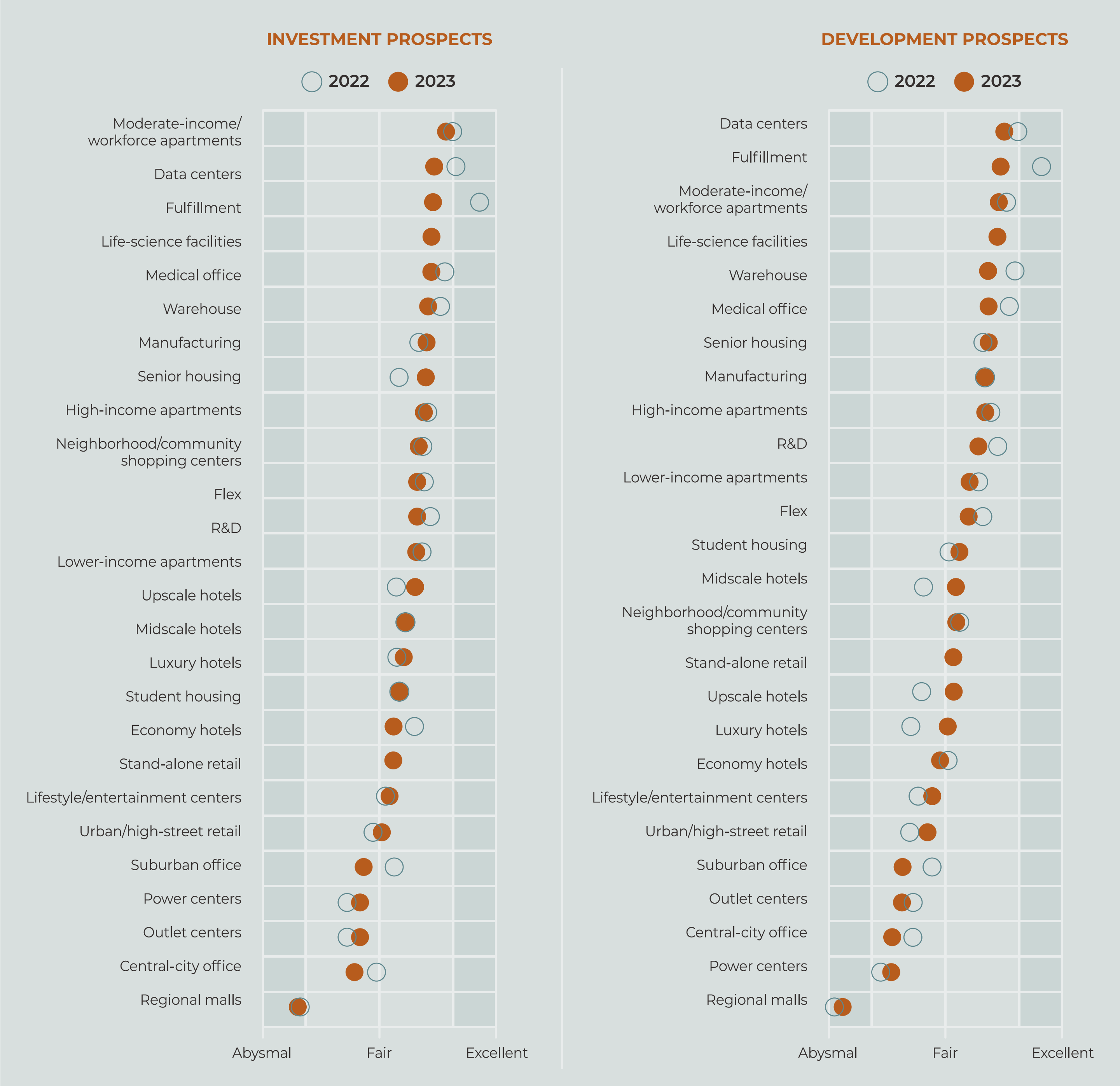
driving 2023 trends, most of which reflect continuing fallout from the global pandemic.

- **Labor shortage**
- **Supply chain instability**
- **Inflation**
- **The economy**
- **Sustainability**
- **Restoration**
- **Location**

# RANKING PROSPECTIVE PROJECTS

Each year, accounting and advisory firm PwC rates major commercial property types to show where investors and developers are likely to find the best investments. As in 2022, they expect multifamily housing to lead investment and development prospects in the year ahead.

## PROSPECTS FOR COMMERCIAL/MULTI FAMILY SUBSECTORS, 2023 VERSUS 2022




(Source: PwC's Emerging Trends in Real Estate)


# HOSPITALITY TRENDS

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# HOSPITALITY

## HOTELS

While hotel starts in 2023 will show tepid growth due to the overall economy, the industry is rebounding. In 2022, RevPAR reached record highs, exceeding pre-pandemic levels, and room starts increased 37.6% after three years of decline. And for 2023, STR and Tourism Economics predict occupancy rates will increase from 62.8% last year to 63.8% and average daily rates will grow from $145 to $151. Industry experts expect growing business travel will offset softening leisure stays, paving the way for upscale and luxury properties to see the greatest gains.

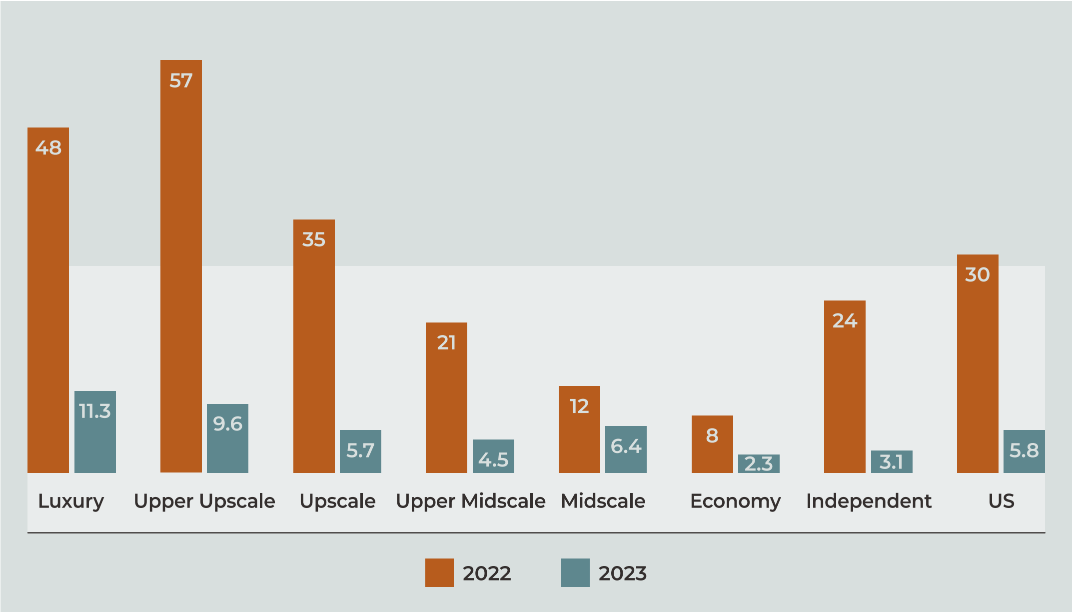
**1.1%**
**CAGR**
through 2028
(Source: CBRE)

**5.8%**
**RevPAR**
in 2023
(Source: PWC)

### HOTEL INVESTMENT PROSPECT TRENDS


(Source: PwC's Emerging Trends in Real Estate)

### PROJECTED U.S. REVPAR PERCENT CHANGE (YEAR-OVER-YEAR)




(Source: PwC, based on STR data)

First impressions will mean everything this year, guiding design trends for new construction and prompting many existing hotels to redesign their lobbies. Open lobbies with star restaurants and bars will provide the It Factor. And gathering areas and coworking spaces (goodbye business centers) will draw business and bleisure (business plus leisure) travelers and digital nomads.

Tech amenities will be more important than ever to accommodate these guests while also reducing:

- Germ spread, as travelers control room features like temperature and lights from their smartphones.
- Reliance on workers, which is especially important with current labor market challenges.
- Energy consumption (e.g., automatic lights off in unoccupied rooms).

Some hotels are now adapting gigabit passive optical networks. Using optical cables, GPONs set the stage to accommodate future tech needs without spending a lot of money, and they are 95% more energy efficient than the standard copper wire used in most networks.

Hotel design likely will fall into one of two predominant categories: grand, classic and lavish or funky, novel and fresh. In both cases, luxurious, soft furnishings will be the way to go.

## DESIGN AND BUILD FOR:

Biophilia for both sustainability and wellness

Cleanliness and safety

Exercise rooms

Funky and chic or grand and posh facilities

Yin and yang color schemes (warm natural tones embellished with rich hues)

Open lobbies with restaurants, bars, coworking and remote worker spaces and tech amenities

Smart technology, gigabit passive optical networks and digital room controls

## RESTAURANTS

Restaurants still haven't reached pre-pandemic traffic, but they're getting close. Food industry advisor David Portalatin from NPD Group told "Foodservice Equipment Report" he expected 2022 to close at 96% of 2019 traffic. Restaurant owners point to three obvious factors slowing the recovery: labor shortages, supply chain issues and inflation.

The International Foodservice Manufacturers Association predicts an overall restaurant decline of 1%, with quick-service restaurants seeing the smallest decline at 0.8%, followed by casual and fast casual. Midscale dining is likely to see the most significant decline at 2.2%. At the same time, however, IFMA projects growth of 2.4% in onsite segments, partly because they were slower to recover from 2020 and because onsite locations are recession-proof.

Because of the workforce situation, restaurants that automate and integrate labor-saving technologies will likely fare better as the labor disruption continues. And restaurants that offer memorable experiences and feature Instagram-worthy, creative design will likely be among those consumers choose when they do go out, particularly during inflationary periods and recessions.

Portalatin also said digital restaurant orders more than doubled last summer compared with summer 2019. As digital orders continue in extraordinary numbers, ghost kitchens, where operators prepare food for off-premises consumption, have become a stable model for restaurants. So we can expect more of those in the future.

### DESIGN AND BUILD FOR:

Automation and labor-saving technologies

Extraordinary interiors that consider all the senses

Ghost and dark kitchens

Open kitchens

Outdoor and rooftop dining, including four-season outdoor dining

Sustainable, eco-friendly design and building materials

**-0.1%**

in operator spending (Source: IFMA)


# INDUSTRIAL TRENDS

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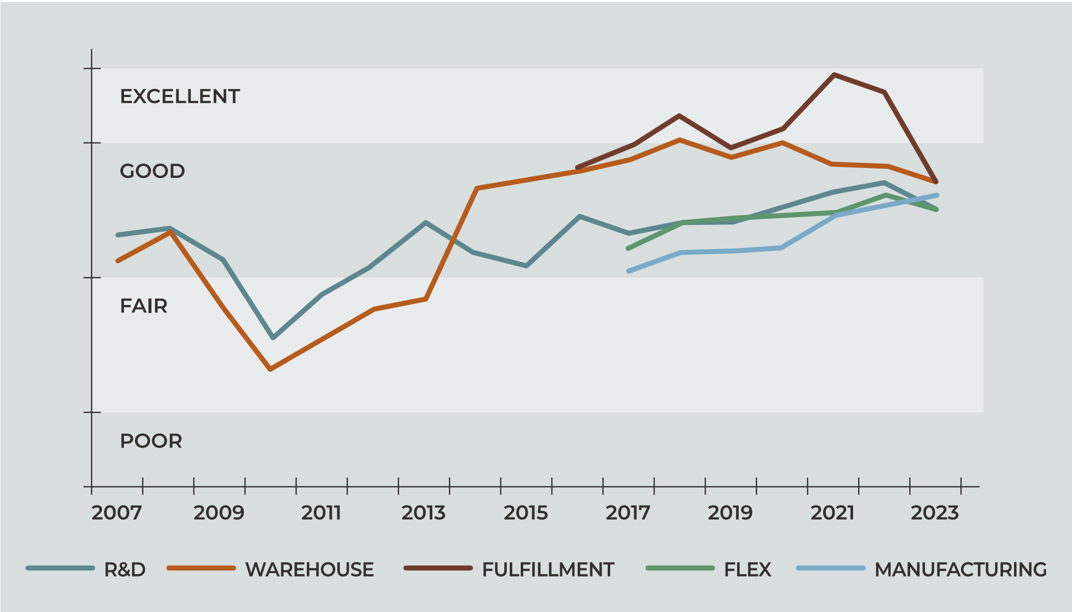
# INDUSTRIAL SECTOR TRENDS

## INDUSTRIAL/DISTRIBUTION INVESTMENT PROSPECT TRENDS




(Source: PwC's Emerging Trends in Real Estate)

**-43%**

(Source: Dodge Data & Analytics)

**The pandemic continues to significantly impact the industrial sector, primarily due to resulting supply chain issues. That portends a mixed bag of opportunities in 2023.**

## WAREHOUSES

As companies began holding more extensive inventories to safeguard against future supply chain issues in 2021, demand for warehouse space soared and is still flying high as 2023 begins. Developers saw the need and the opportunity and went right to work building new warehouse space. But those same supply chain issues they're trying to avoid have spoiled completion rates, and warehouse space right now remains scarce, with rents increasing by as much as 400%. But when many of those new warehouses are completed, by the latter half of 2023, we're likely to see a surfeit of space.

While there are, and will still be, pockets of need for more space in 2023-2024, warehouses no longer present the same promising investment they did last year.

## MANUFACTURING

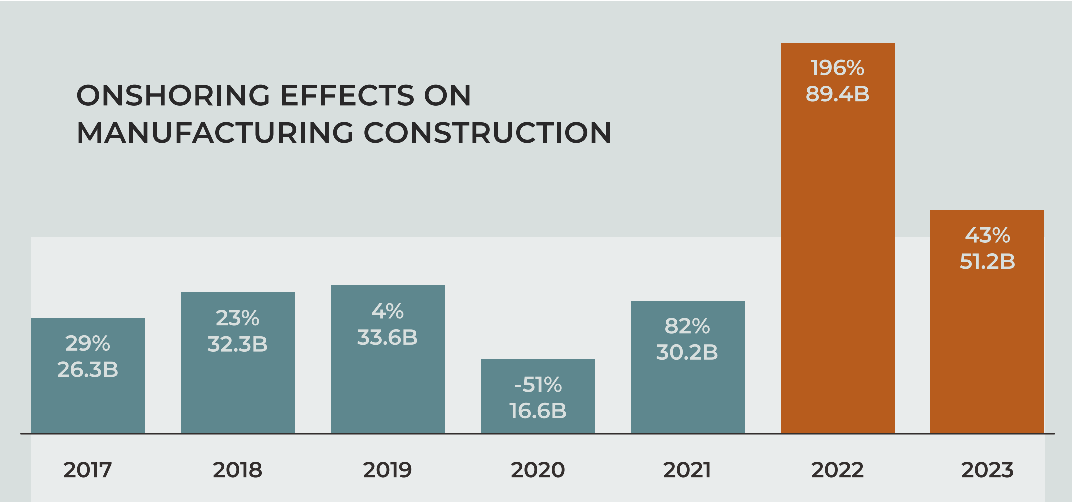
We see the opposite in manufacturing, also as businesses work to ward off future supply chain challenges. As more businesses reshore operations, the U.S. needs more manufacturing plants, particularly for large-scale operations such as chip fabrication and electric car battery production.

In 2022, manufacturing starts reached $89 billion. And while Dodge Data & Analytics expects them to decline to about $51 billion this year, they remain at a level unseen since Dodge began tracking the data in 1967.

"For Construction Pros" reported that in Dodge Data & Analytics' construction industry outlook, Chief Economist Richard Branch said, "If not for 2022, that $51 billion would be a record level of construction in terms of nominal dollars, or even its square footage, which is pretty much as real as you get. You need to go back to the early 1990s to see the kind of square footage we expect will break ground in 2023."

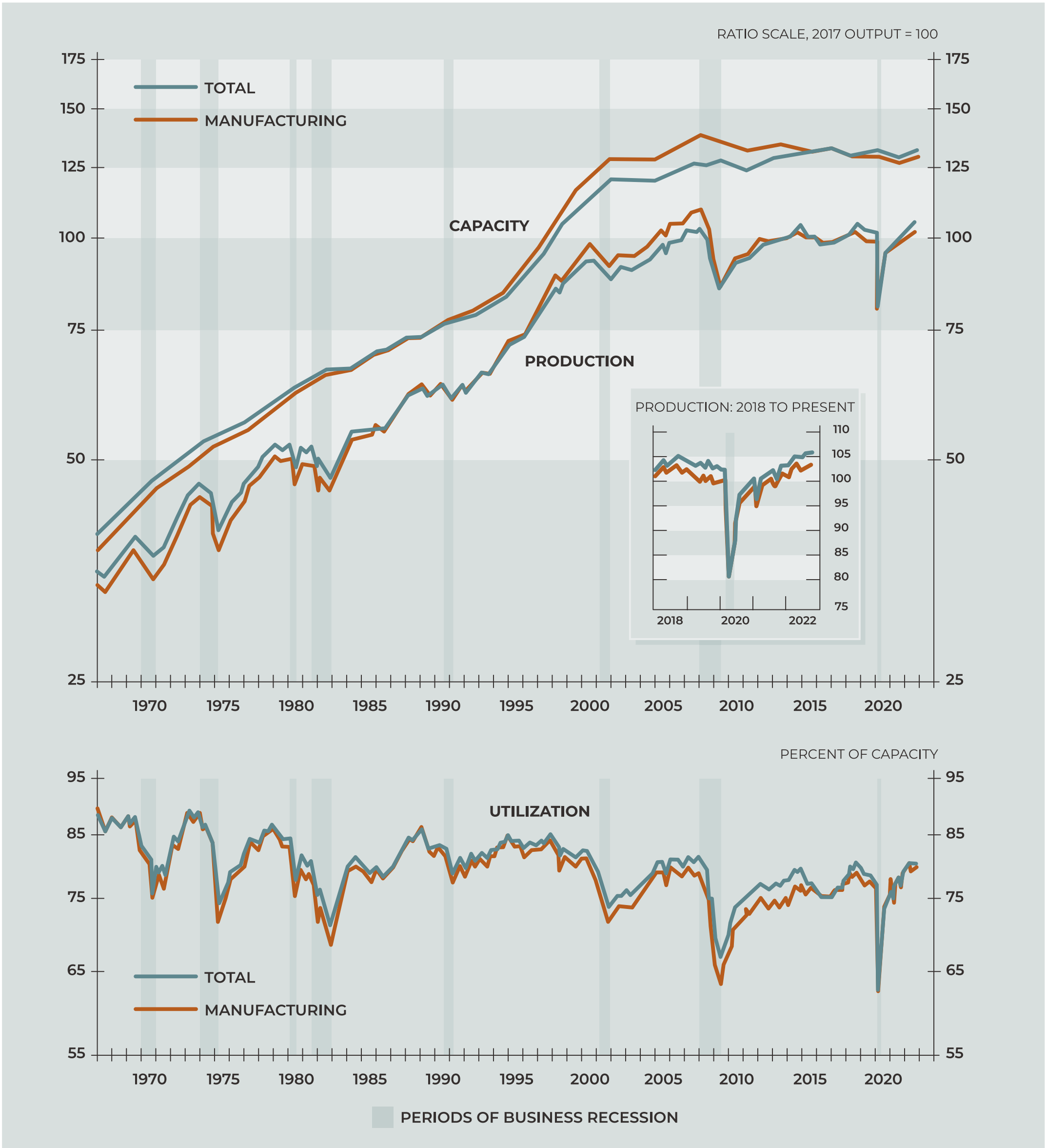
Of course, that doesn't mean sufficient labor will be available to fully staff new facilities, increasing the need for automation and advanced technology.

## MANUFACTURING CONSTRUCTION STARTS (BILLIONS OF DOLLARS)

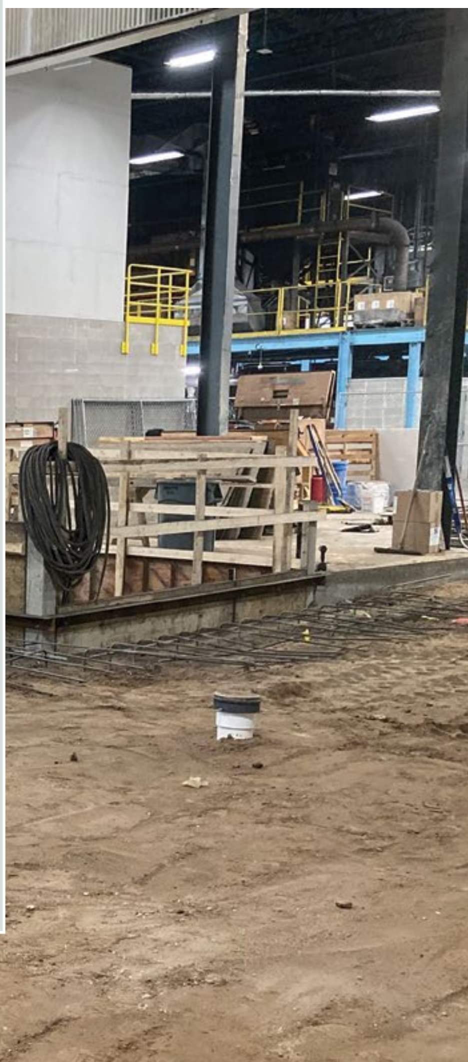



(Source: Dodge Data & Analytics)

## U.S. INDUSTRIAL PRODUCTION, CAPACITY AND UTILIZATION




(Source: Federal Reserve)



## DESIGN AND BUILD FOR:

Autonomous robotic systems

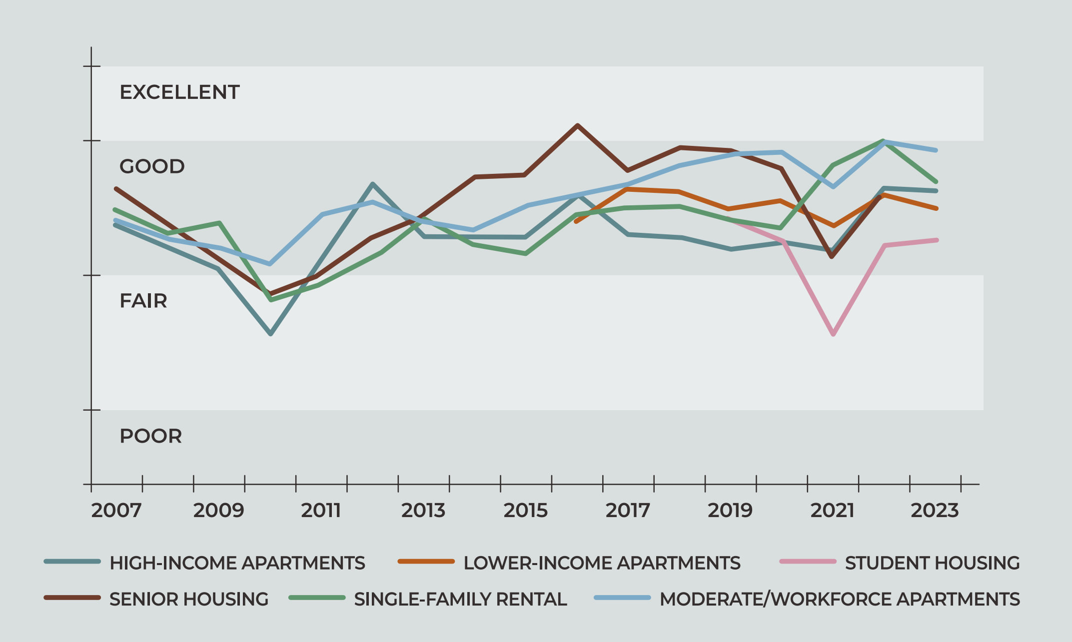
Industrial Internet of Things, including remote monitoring, artificial intelligence and machine learning for predictive maintenance and solutions

Energy efficiency and sustainability

# MULTIFAMILY TRENDS

# MULTIFAMILY HOUSING TRENDS

## APARTMENT INVESTMENT PROSPECT TRENDS




(Source: PwC's Emerging Trends in Real Estate)

**-9%**

(Source: Dodge Data & Analytics)

While Dodge Data expects multifamily starts to decrease 9% from 796,000 last year to 723,000 units in 2023, vacancy rates were at a five-year low at the end of last year, and demand remains high. The economy is the most significant factor driving multifamily housing construction. Rising interest rates and a dearth of single-family homes have financially locked many consumers out of home ownership.

JP Morgan currently identifies multifamily housing as the highest performing of all asset classes, perhaps because it's an investment that weathers today's economic tides.

- It's recession-proof because demand doesn't diminish even as the economy contracts.
- Inflation is less of a challenge because owners can reset leases as often as every 12 months.
- Multifamily housing can withstand fluctuating interest rates, particularly when financed through Fannie Mae and Freddie Mac.

Further, multifamily housing will be needed well into the future. Already, renters comprise more than a third of the U.S. population, according to Statista Research & Analysis. Plus, Gen Z is now entering the rental housing market. As the largest generation in history, they will impact the market for several years to come.

## WORKFORCE APARTMENTS

Workforce apartments are the most needed category of multifamily housing. The National Multifamily Housing Council and the National Apartment Association predict the U.S. will need 4.6 million additional rental units by 2030. The deficit has spurred numerous grants and incentives for developers, making financing more attainable. Such programs also help offset the increased cost of materials and higher interest rates.

Workforce apartments are designed for middle-income workers (who make between 80% and 120% of the area median income) such as teachers, public servants and retail clerks. It's a group that, while not seeking luxury amenities, is looking for mid-range comforts, such as outdoor spaces (gardens, terraces, rooftops, playgrounds, dog parks) and recreational and wellness areas (workout rooms, pools).

Materials that hark to nature — earthy, neutral colors, soft, natural materials and natural light — will increase demand for your property.

### DESIGN AND BUILD FOR:

Adaptive reuse

Biophilia

Health and wellness

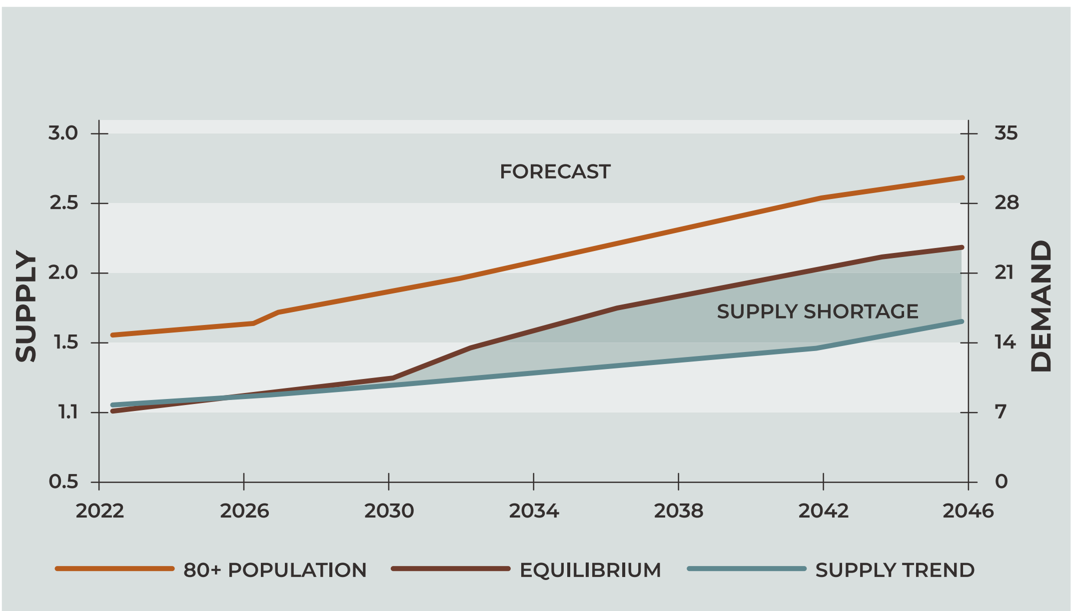
Roofs, terraces and outdoor access

Soft, natural materials

Sunlight and neutral colors

## SENIOR HOUSING

### SENIOR HOUSING SUPPLY VS DEMAND TRENDS




(Source: National Investment Center for Senior Housing & Care)

## PROJECTED SUPPLY NEEDED IN 2029 TO FILL MIDDLE-MARKET SENIOR HOUSING DEMAND AT CURRENT COSTS

| ANNUAL RENT | MEDICAL OUT-OF-POCKET | TOTAL COST | NUMBER OF MIDDLE INCOME SENIORS WHO CAN AFFORD THE TOTAL COST (MILLIONS) | PERCENTAGE OF MIDDLE INCOME SENIORS WHO CAN AFFORD THE TOTAL COST | UNITS NEEDED AT DIFFERENT PENETRATION RATES 11% | 14% |
|---|---|---|---|---|---|---|
| $40,000 | $5,000 | $45,000 | 10.2 | 71% | 1,145,088 | 1,431,360 |
| $40,000 | $10,000 | $50,000 | 9.0 | 63% | 1,008,000 | 1,260,000 |
| $55,000 | $5000 | $60,000 | 6.6 | 46% | 739,200 | 924,000 |
| $55,000 | $10,000 | $65,000 | 5.3 | 37% | 593,600 | 742,000 |
| $75,000 | $5000 | $80,000 | 2.9 | 20% | 324,800 | 406,000 |
| $75,000 | $10,000 | $85,000 | 2.1 | 15% | 235,200 | 294,000 |

(Source: National Investment Center for Senior Housing & Care and NORC)

## DESIGN AND BUILD FOR:

Adaptability of spaces

Air filtration

Continuum of services

Disinfecting

capabilities

Family involvement

Natural light

Soft, natural materials and colors

Wellness

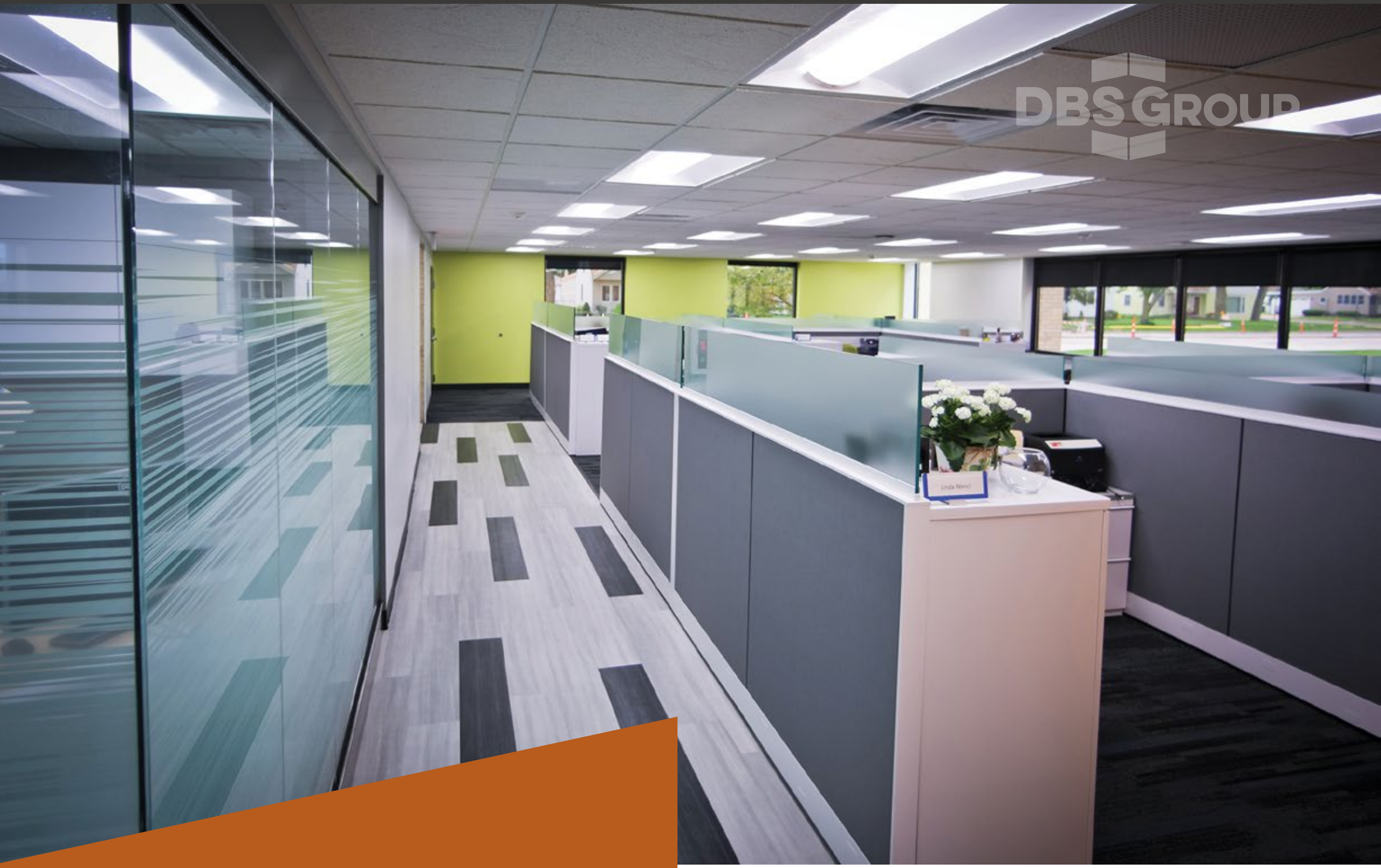
While experts don't expect a stellar year for senior housing, the need for it is fueling up and nearing takeoff time. In 2022, there were 10.6 million Americans aged 82 and older, and the U.S. Census Bureau projects that number to grow 40% by the end of the decade. Demand is already surging. NIC MAP Vision reported increased occupancy rates for senior housing across the board last year.

When developing senior housing facilities, it's wise to design and build for a service continuum to accommodate aging in place. And incorporating adaptable spaces, wellness options and advanced technology, such as voice-activated tools and telehealth, remain essential. And don't forget the lessons learned during the pandemic; you'll want to design for air filtration systems, self-cleaning surfaces and disinfecting capabilities.

The biggest challenge currently facing senior living communities is staffing, making it essential for facilities to feature amenities not just for residents but for staff too. Be sure to consider space for employees to rest and recharge during breaks. Entice them with thoughtful staff rooms, exercise space and equipment, and maybe even onsite daycare.

You might also design spaces for family involvement, where children or grandchildren may stay and assist in caring for their loved ones — thereby helping abate staffing challenges.

Of course, residents and staff alike will enjoy — and benefit from — a back-to-nature approach when it comes to design. Soft, neutral colors, elements from nature and sunlight will help close the deal with them.



# OFFICE SPACE TRENDS

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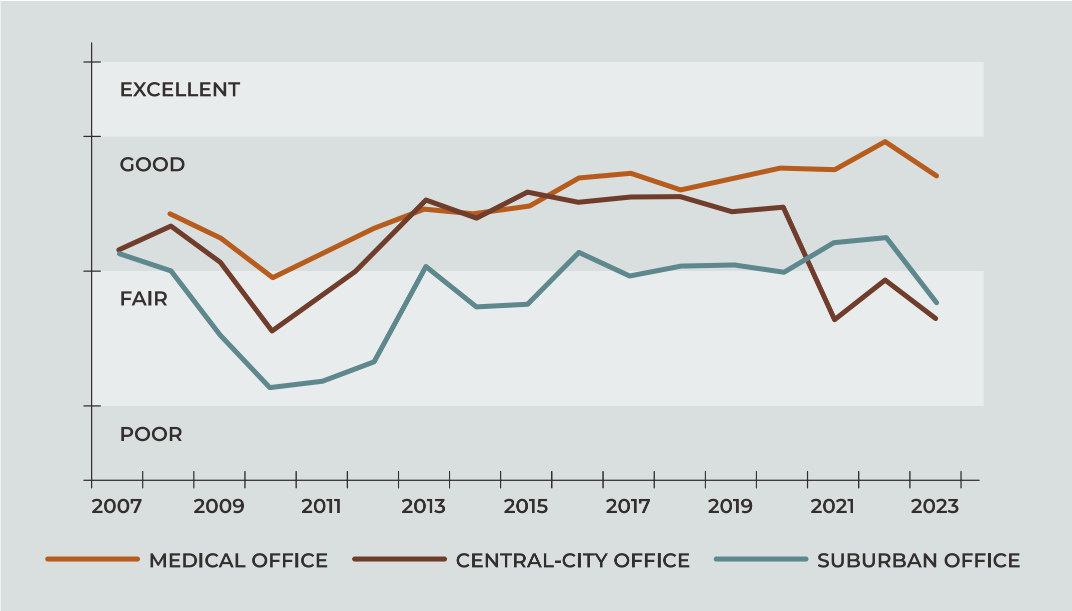
# OFFICE SPACE

## OFFICE INVESTMENT PROSPECT TRENDS




(Source: PwC's Emerging Trends in Real Estate)

Office construction is in flux as we begin 2023, as many employers are still figuring out how best to manage a hybrid workforce, and many industry watchers predict it could take a couple more years to sort it all out. In the meantime, employers are not only seeking ways to lure workers back to the workplace at least for two to three days a week; they're also competing for workers.

With the uncertainty, new office construction is not expected to grow in 2023, but renovations are. Global Market Insights predicts 4% growth in commercial renovations overall, and Dodge Data reported that office sector renovations, specifically, comprised about a third of all office construction in 2021 and nearly half (46%) in 2022.

While increasing productivity and attracting and retaining workers are part of the motive, so are shrinking the space they occupy and implementing energy-saving measures to reduce expenses.

Creating convertible, multi-function spaces for various types of work will be critical in these renovations, as will mimicking the comforts of home. "Resimercial" design (combining residential and commercial components) calls for fewer closed offices and more space for small conversations, large collaborations, gathering spots, and community areas. It also means incorporating more natural light and accessorizing with comfortable furniture in various groupings. And flexible design will serve employers well as they experiment to find what works best for their company.

And don't forget about the wellness factor. Body and mind restoration will fuel productivity, so consider exercise rooms, outdoor space and rich amenities.

Making the office a workplace destination can help you attract top talent, entice workers to return to the office and increase productivity and profit.

**-1%**

(Source: Dodge Data & Analytics)

### DESIGN AND BUILD FOR:

Hybrid workforce (open design with convertible spaces)

Biophilia and well-being

Sustainability (low-carbon materials, modern HVAC)

Lighting systems that mimic natural light

Comforts of home
Mixed color palettes to spur creativity in some areas, deep focus in others

Flexible technology, especially in meeting rooms


# RETAIL TRENDS

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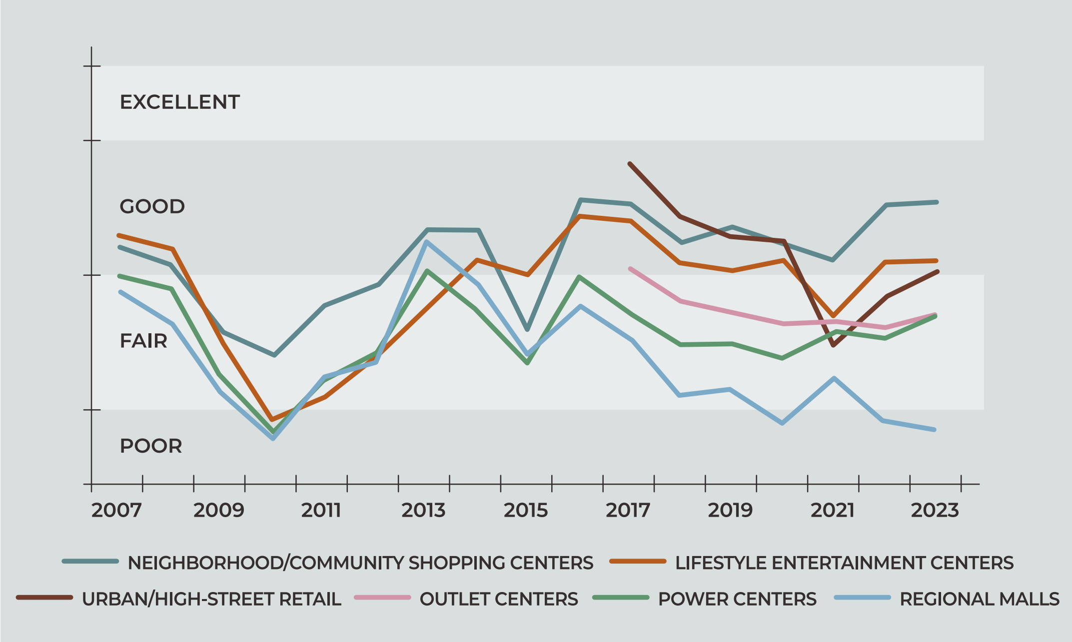
# RETAIL

## RETAIL INVESTMENT PROSPECT TRENDS




(Source: PwC's Emerging Trends in Real Estate)

A year ago, the retail sector was rebounding nicely from pandemic lows. In fact, U.S. retail sales were expected to come in at $4.8 trillion for 2022, representing a 12% increase over 2021, according to data from Statista Research & Analysis. But some economists doubt the growth will continue, given the twofold blow of inflation and recession.

Despite the doubt, PwC anticipates an uptick in retail investment across the board in 2023. And Forrester's Predictions 2023: Retail report forecasts $3 of every $4 of the expected $4.7 trillion in U.S. sales will occur in brick-and-mortar locations.

Forrester went a step further, suggesting this is the year for online-only operations and direct-to-consumer brands to add physical locations to ensure future growth — or close shop. As more consumers return to physical stores, they will be the best channel to find new customers.

For the best opportunities, seek areas with growing populations and new single-family home developments. Dodge Data Chief Economist Richard Branch said there's typically a one-year lag between groundbreakings for single-family homes and groundbreakings for retail developments.

When new brick-and-mortar retail locations do arise in 2023, the most successful ones will do so with efficiency and engagement measures for customers and with automation, both in-store and in the back office, to compensate for labor shortages.

They'll also integrate technology that combines online shopping features with in-store experiences to appeal to shoppers who became accustomed to the speed and convenience of online shopping during the height of the pandemic and now visit physical locations to see, feel, test and immediately possess goods. Doing all that while enhancing the customer experience with a unique ambiance, good vibes and eco-friendly touches will be key to bringing them back for more.

**-4%**

(Source: Dodge Data & Analytics)

### DESIGN AND BUILD FOR:

Advanced technology and automation

Ambient, accent and decorative lighting

Brand aesthetic and colors

Checkout-free systems

Convenient pickup for online orders

Experiential installations

Focal point displays

Hybrid physical and digital shopping

In-store kiosks

Natural materials

Sustainability


## GROCERY

The U.S. grocery store market grew 4.5% in 2022, and Statista Research & Analysis projects it will continue growing by 3.38% CAGR through 2027.

The growth comes as more people are cooking and eating meals at home. In a 2021 study conducted by the Food Industry Association, 58% of participants reported eating at home more than before the pandemic. And in a study last year by Advantage Sales, a U.S. food-distributor-turned-marketing-agency, nine in ten households said they buy most of their groceries in stores. Seeking fresh, healthy meal solutions, these consumers are also visiting stores more frequently.

With a focus on restoration, seven out of ten shoppers look for ways to lessen their carbon footprint, according to a report from the Coca-Cola Retailing Research Council. And they're willing to pay 4% more at grocery stores that are environmentally and community conscious. So if you're considering building a grocery store, be sure to incorporate energy-efficient equipment, reduce plastics and use recycled materials wherever feasible, from construction to takeout containers.

Experiences also matter to today's consumers who want to see, feel, smell and even taste products before purchasing them. As a result, grocers throughout the U.S. find that bringing in a steady rotation of new, unique products keeps customers returning to traditional stores.

To manage increased traffic and demand amid the labor shortage, robotics and automation are being increasingly implemented to reduce product handling costs and manage order assembly.

Most interesting, perhaps, are the opportunities for retail in mixed-use developments, like live-work-play projects and community centers. Featuring a necessity-based store like a supermarket with other retailers increases the likelihood of success for the entire development.


# BREAKING NEW GROUND IN CONSTRUCTION

If you're considering a new commercial construction project, contact DBS Group to learn how we can leverage our design-build expertise to drive value for your project. You'll find our design, preconstruction and construction services can help you create an investment poised to bring positive returns for years to come.

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