

TOP-DOWN INVESTMENT ANALYSIS **UPDATED**

State-by State Rankings

SPECIAL REPORT | JUNE 2023



**MORRISON
STREET
RESEARCH**

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SOURCES:

Morrison Street Research
U.S. Census Bureau
Alaska Department of Labor and Workforce Development
American Community Survey
Bureau of Labor Statistics
Zillow
Council for Community and Economic Research
The Pew Charitable Trusts
NOAA
Reason Foundation
Inrix
FBI Crime Statistics
FEMA
US News and World Report
Tax Foundation
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Letter from the Editor



RANCE GREGORY
CEO

We are honored to present our third annual Top-Down analysis of U.S. States from Morrison Street Research. The enclosed report takes a bird's-eye view of those states currently most favorable for commercial real estate investment based on their recent and near-term potential for growth.

In developing our analytical framework, we reviewed population and employment statistics, state fiscal considerations, quality of life, and key demographic measurements to create both component and overall ranking systems. The study highlights regional job and population changes, which are the key determinants of both occupier and investor demand for commercial real estate.

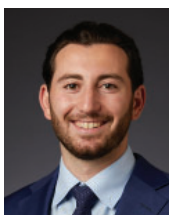
We have also included our standard due diligence supplement to frame our approach to investment underwriting.

We hope you'll find this report interesting and informative. We look forward to any questions or comments you may have regarding this report's data and our conclusions.

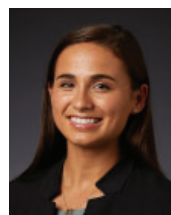
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Overview of the Top-Down Investment Study

Thoughtful commercial real estate investing requires an approach that considers both a top-down perspective of important economic drivers in a subject property’s broader geographic area, as well as a traditional bottom-up due diligence process factoring a subject property’s rent roll, income and expense information, leasing and sale comps, and supply/demand data within the relevant submarket.

We frequently have the opportunity to communicate to our clients the results of our bottom-up analysis of specific investments in commercial real estate properties. However, we less often have the occasion to share the factors that inform our top-down analysis of markets that have more or less potential for growth and value creation. To that end, we would like to share our recently completed review for all 50 States and the District of Columbia of 26 high-level measurements that we believe are relevant in the context of making investment decisions.

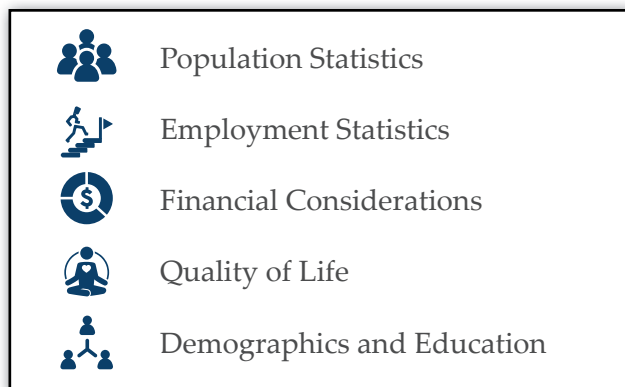
There are many ways to interpret the results of the data enclosed. Our purpose here is to provide a filter for viewing the potential for investment risk and return in various geographic locations. In other words, someone applying a different analytical filter could draw a different conclusion from the same set of data. What is important for this study is to detect and project the movement of population and jobs in and out of particular regions and specific states. In a separate report, we also work this data down to cities, beginning with the top 50 MSAs.

As a quick look backward, Exhibit A illustrates total population movements among regions since 1970. As you can see, there has been a long and substantial migration of residents from the Midwest and Northeast into warmer (and in many cases, lower tax) climates in the West, Southwest and Southeast regions.

Exhibit A

Region	1970 Population	2022 Population	Total Population Growth 1970-2022	% Growth 1970-2022
Northeast	48,999,999	57,040,406	8,040,407	16%
Southeast	49,042,364	94,666,820	45,624,456	93%
Midwest	56,577,067	68,787,595	12,210,528	22%
Southwest	16,544,465	43,521,913	26,977,448	163%
West	32,020,877	69,270,823	37,249,946	116%
Totals	203,184,772	333,287,557	130,102,785	64%

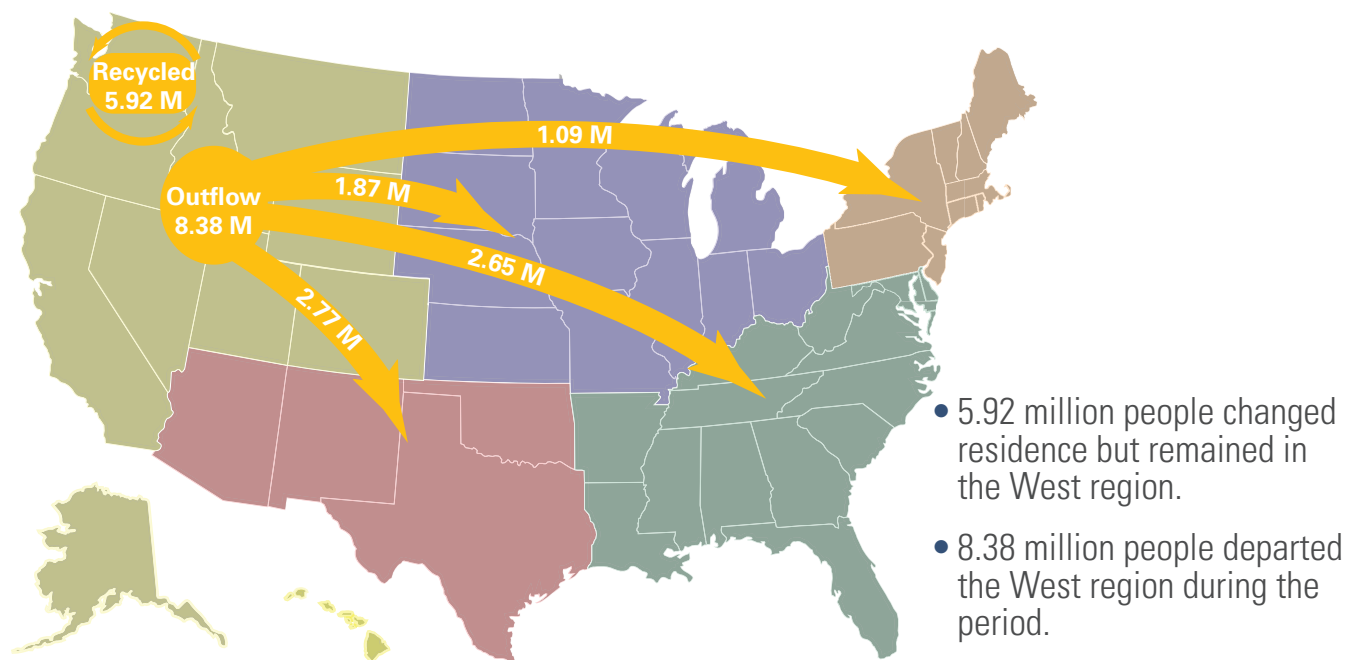
To determine the states most suited to near-term investment, we conducted the following top-down study applying 26 distinct measurements to all 50 States and the District of Columbia. We separate our analysis into five key categories, shown in order of relative importance:



As we like to say, commercial real estate houses the economy. Unless burdened by a prior oversupply of new product, areas with increasing population and jobs should produce additions to occupied space. Higher occupancies lead to greater rental rates, which can produce more net operating income, and lead to higher property values. Conversely, areas experiencing slow or negative growth in population and jobs could be expected to lose ground in achieving gains of property income and value. For many key population and employment statistics, we factored in both the absolute size of the state (the more people and the more jobs in a state, the better), and we also weighted the rate of increase on a percentage basis (to adjust for states experiencing more or less relative growth).

Gross Population Outflows

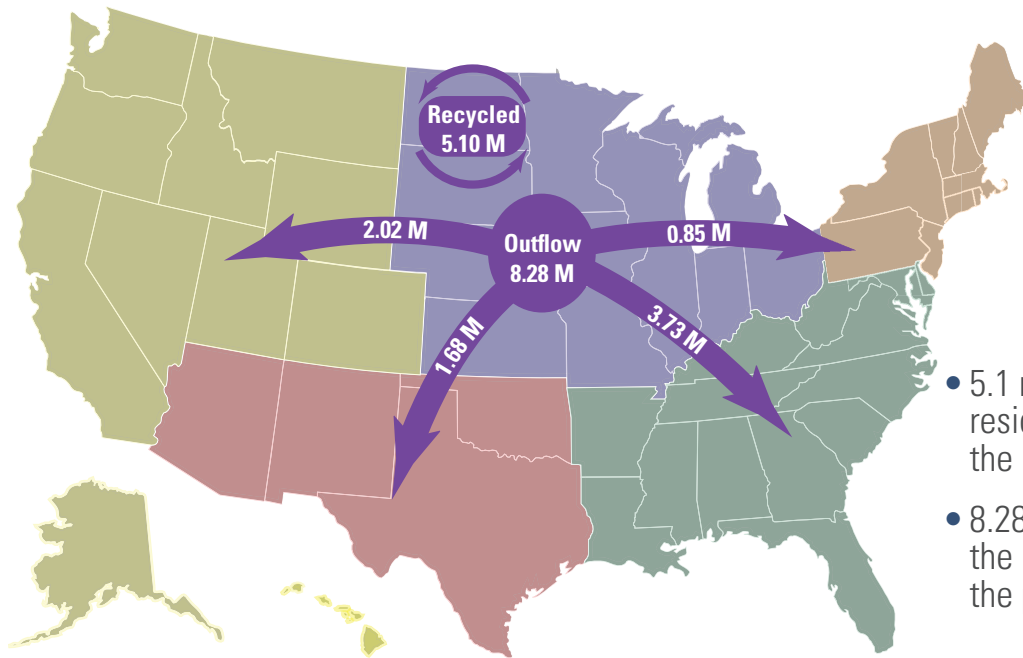
WEST REGION | 2012-2021





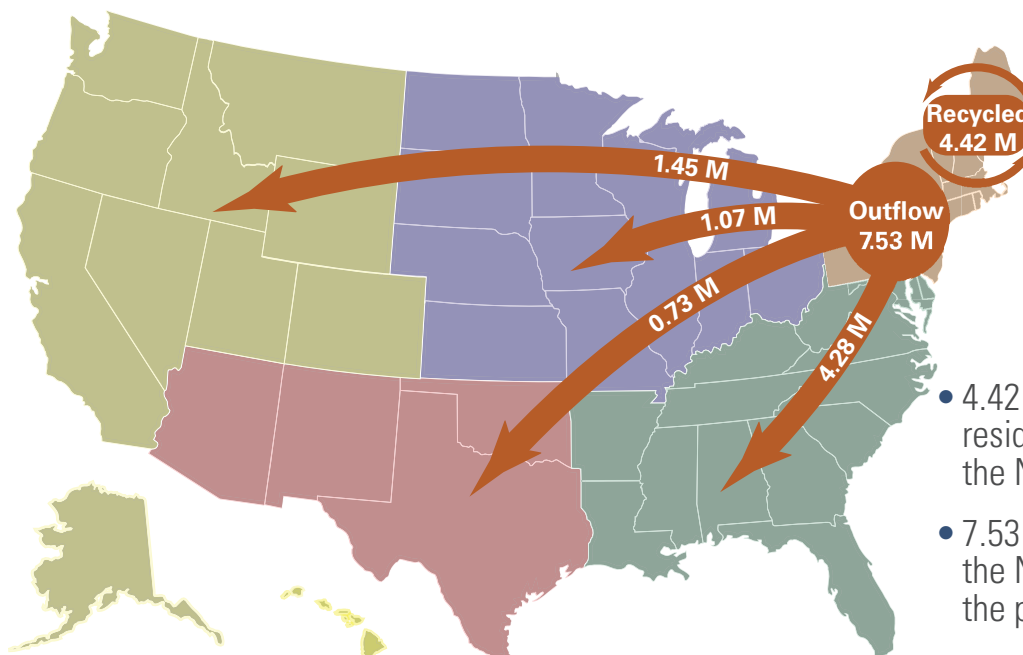
Gross Population Outflows

MIDWEST REGION | 2012-2021



- 5.1 million people changed residence but remained in the Midwest region.
- 8.28 million people departed the Midwest region during the period.

NORTHEAST REGION | 2012-2021

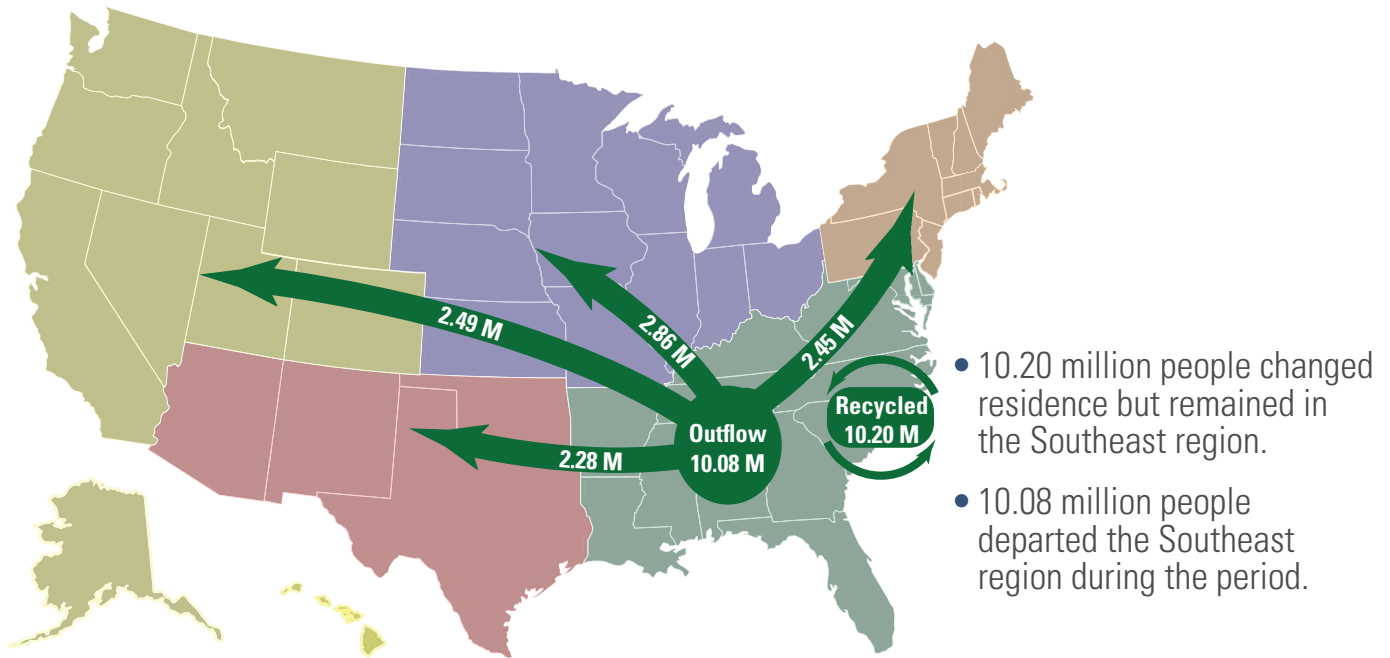


- 4.42 million people changed residence but remained in the Northeast region
- 7.53 million people departed the Northeast region during the period

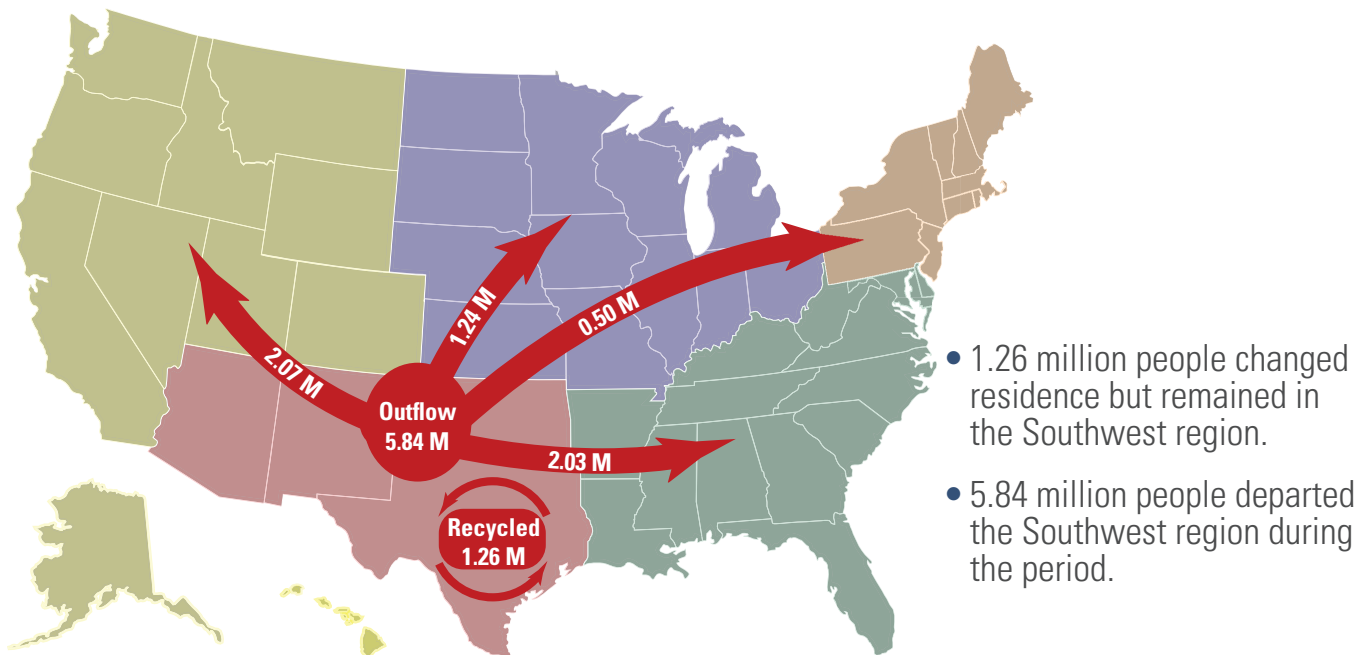


Gross Population Outflows

SOUTHEAST REGION | 2012-2021



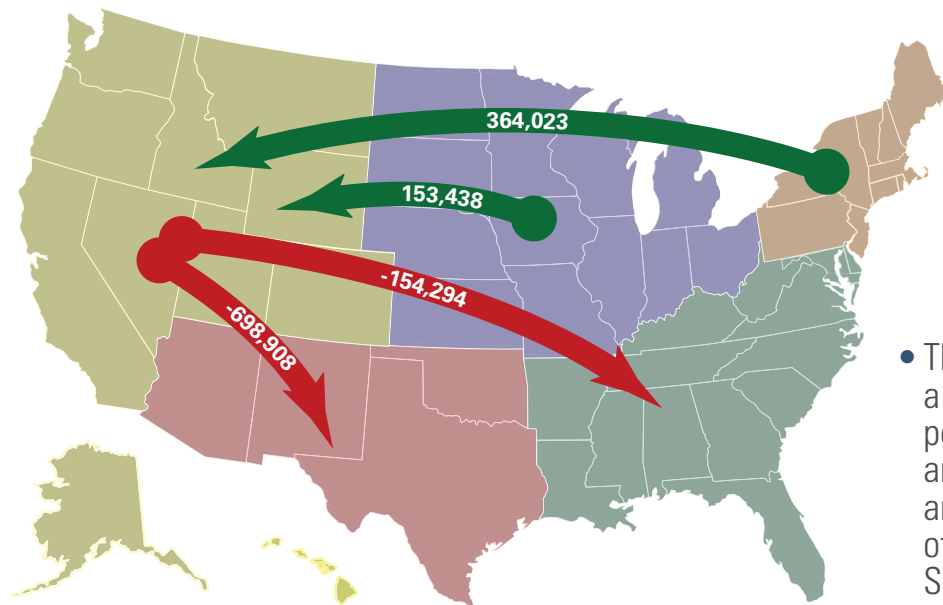
SOUTHWEST REGION | 2012-2021





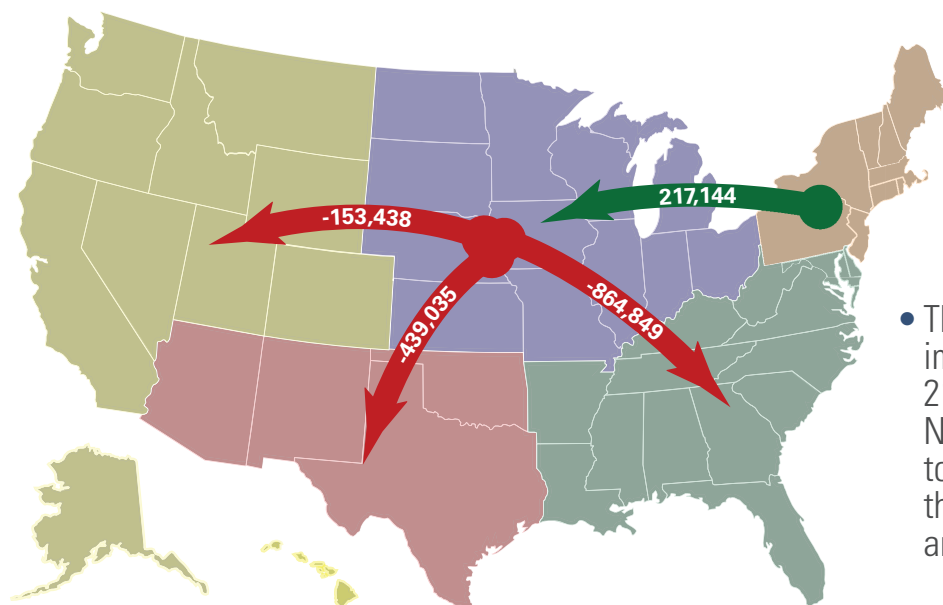
Net Migration (inflows minus outflows)

WEST REGION | 2012-2021



- The West region imported a net total of 517,461 people from the Northeast and Midwest regions and exported a net total of 853,202 people to the Southwest and Southeast regions.

MIDWEST REGION | 2012-2021

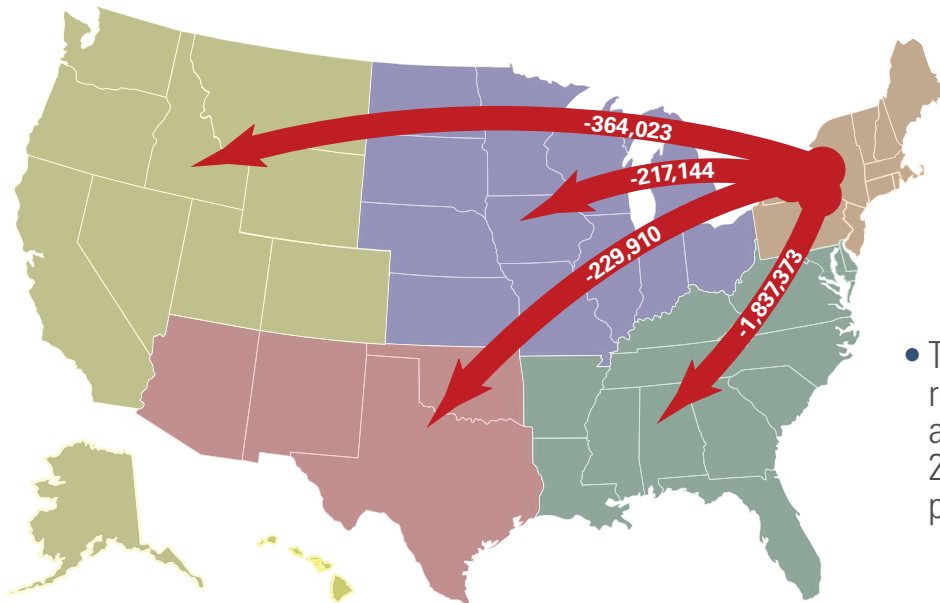


- The Midwest region imported a net total of 217,144 people from the Northeast and exported a net total of 1,457,322 people to the Southeast, Southwest and West regions.



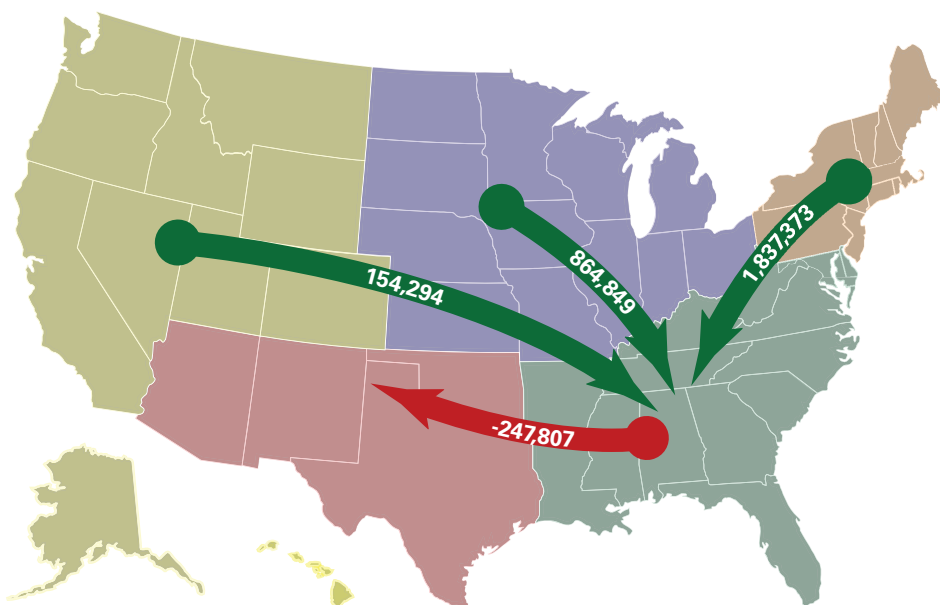
Net Migration (inflows minus outflows)

NORTHEAST REGION | 2012-2021



- The Northeast did not receive any net inflows and exported a net total of 2,648,450 people during the period.

SOUTHEAST REGION | 2012-2021

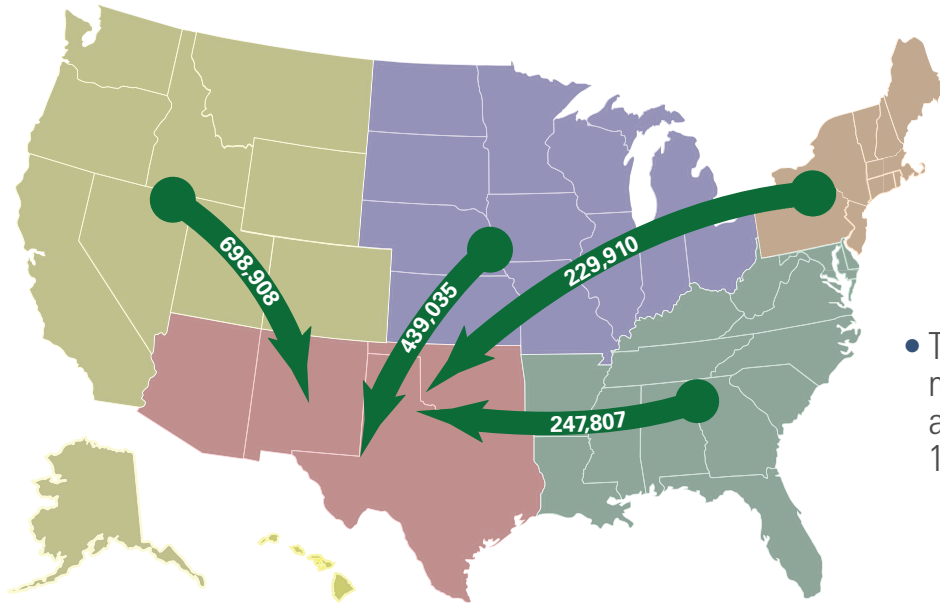


- The Southeast region imported a net total of 2,856,516 from the Northeast, Midwest and West regions and exported a net total of 247,807 people to the Southwest region.



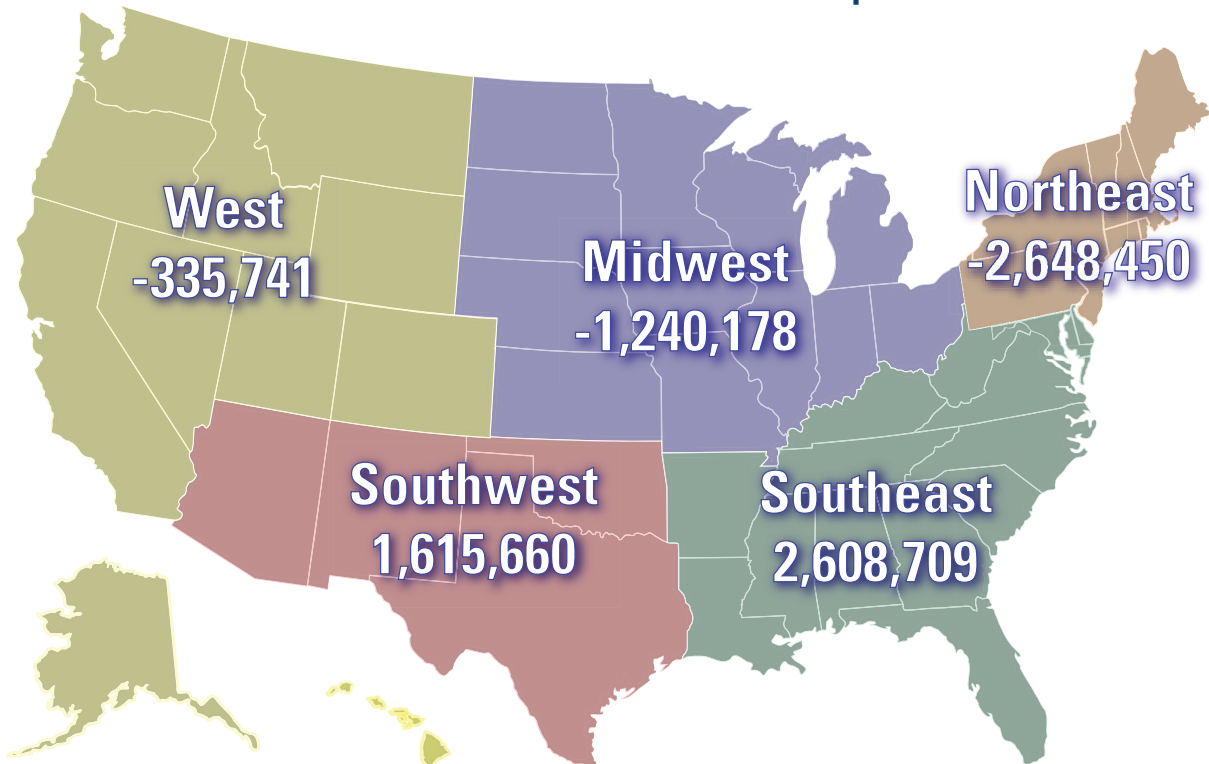
Net Migration (inflows minus outflows)

SOUTHWEST REGION | 2012-2021



- The Southwest did not have net exports to any region and imported a net total of 1,615,660 during the period.

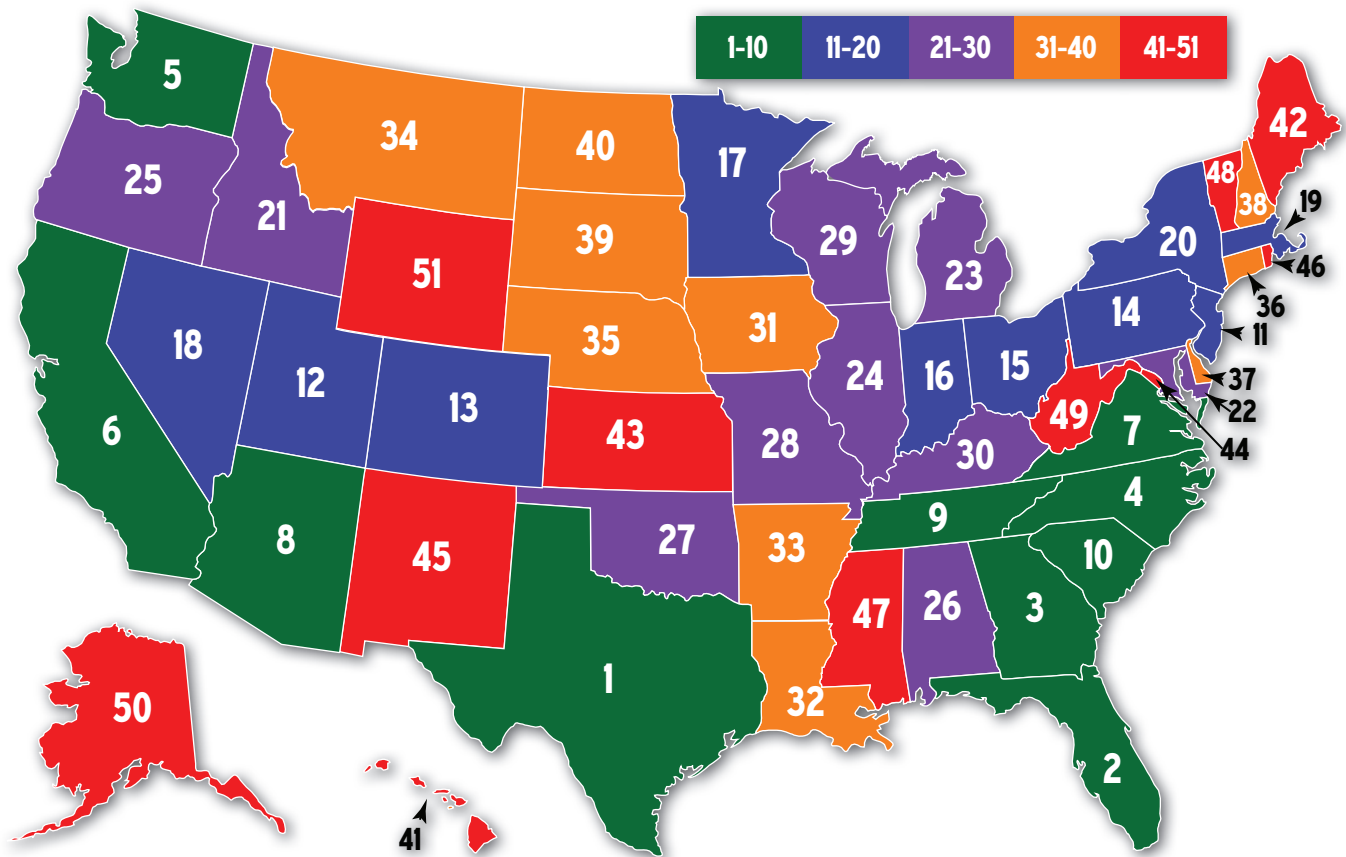
OVERALL DOMESTIC NET MIGRATION | 2012-2021





Population Rankings | 2012-2022

For population growth statistics, we measured state-by-state changes from December 2012 to December 2022. By using both absolute growth numbers and the percentage change, we were able to take into account both the size of a state and the growth rate relative to size.

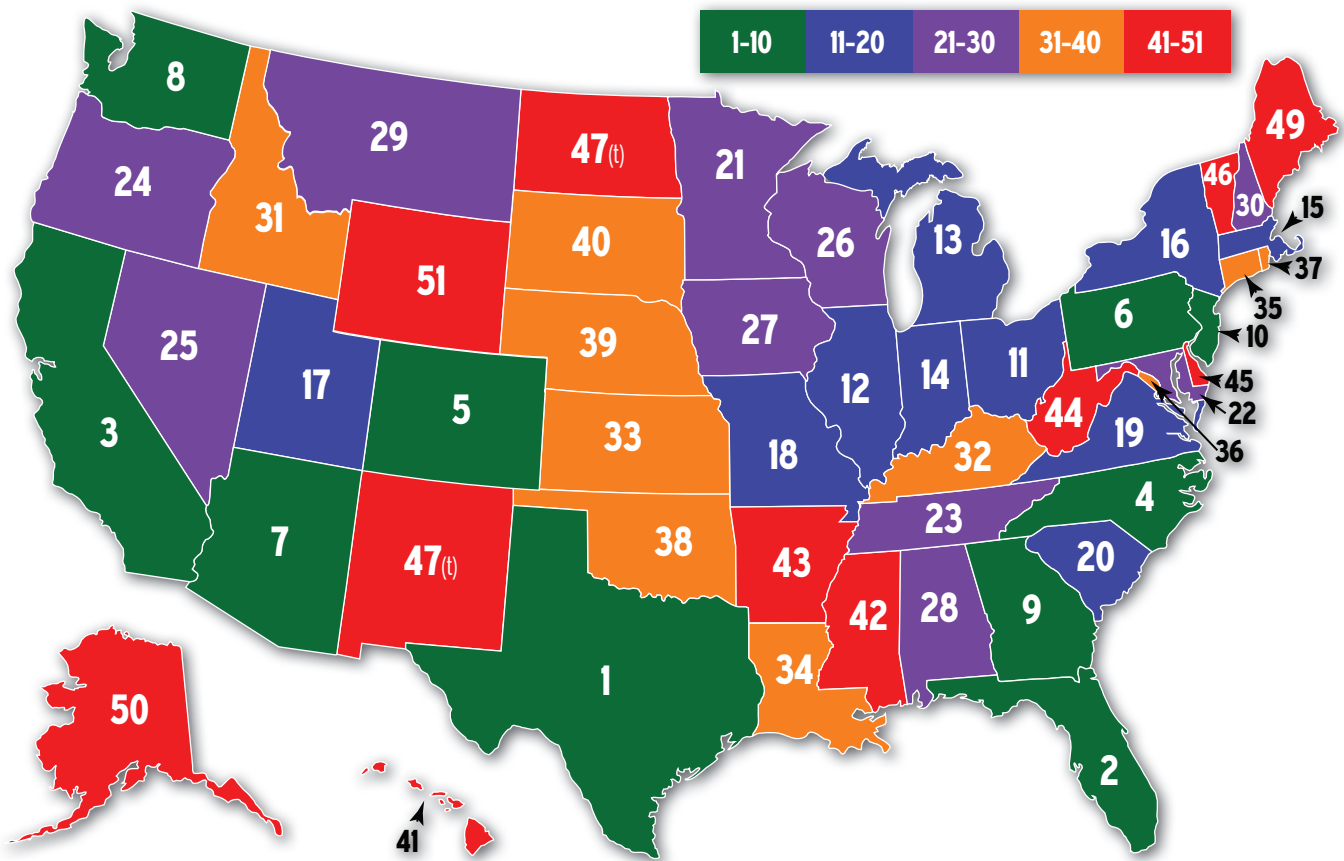


Morrison Street Research's formula weighted the following factors by state:

- State population
- Absolute population growth
- Growth as a percentage change from 2012 to 2022
- Absolute net migration from 2012 to 2022
- Net migration as a percentage change from 2012 to 2022
- Absolute organic growth (births minus deaths) from 2012 to 2022
- Organic growth as a percentage change from 2012 to 2022



Employment Rankings | 2012-2022

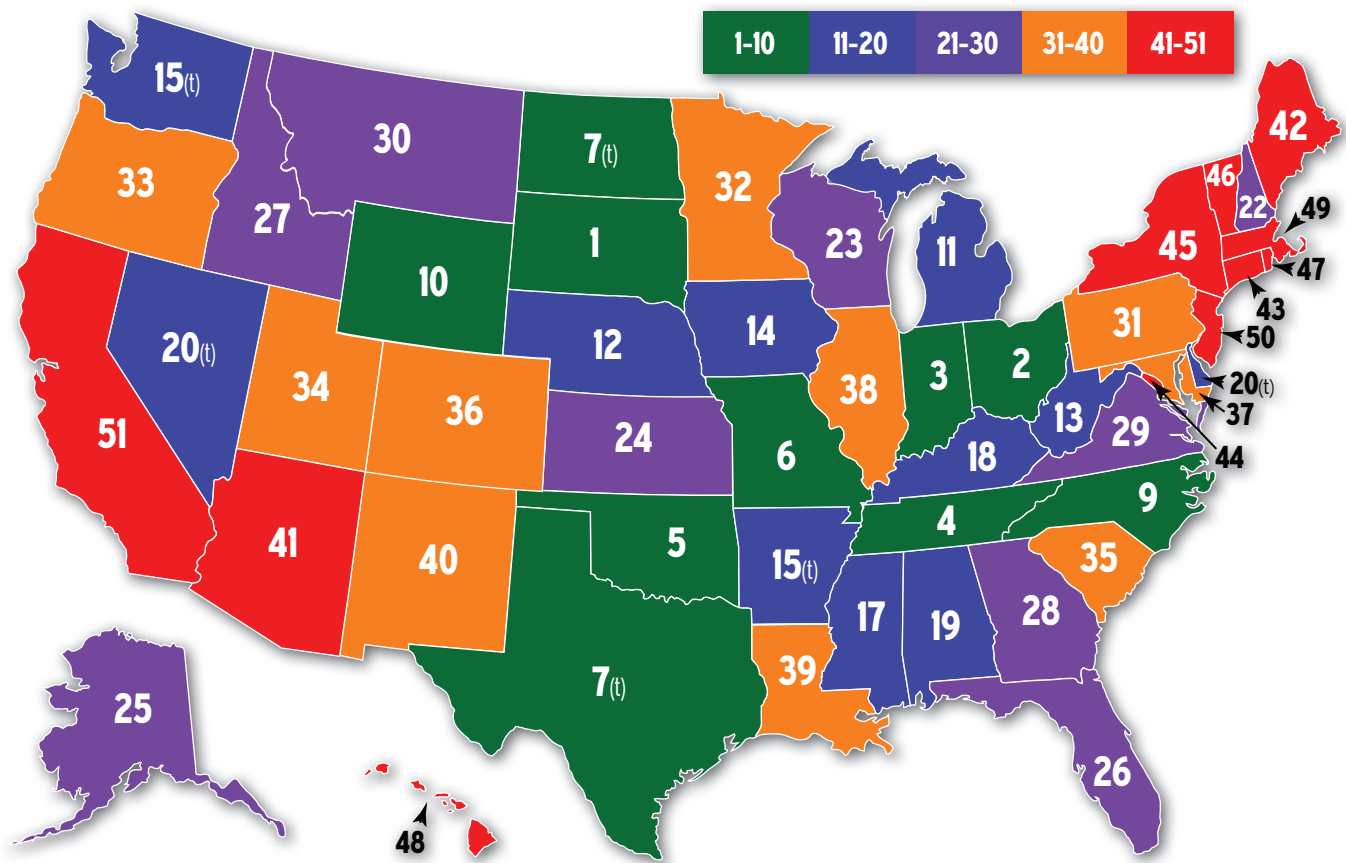


For the ranking method by employment statistics, Morrison Street Research weighted by state:

- Total employment by state
- Absolute change in employment from 2012 to 2022
- The percentage change in employment from 2012 to 2022
- The state unemployment rate
- The percentage of the state population employed



Financial Rankings | 2012-2022

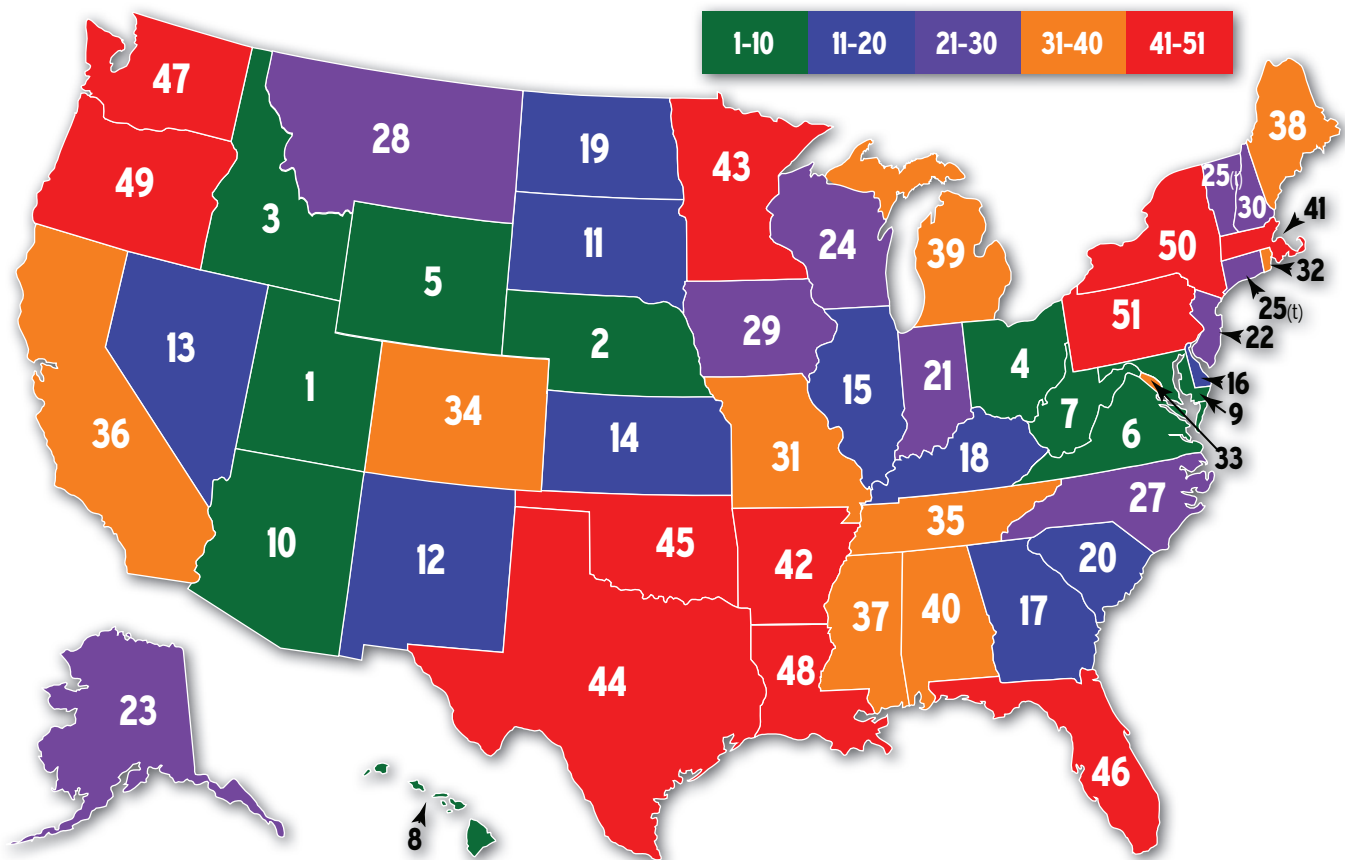


To assess the financial impact to individuals and businesses located within each state, Morrison Street Research took into account:

- Overall tax burden (combined state income, other state and local taxes, and property taxes)
- Median Home Price
- Median Income
- Ratio of Home Price to Median Income
- Cost of Living (includes groceries, housing, utilities, transportation, health care, misc)
- State Fiscal Stability (state revenue and expenses, reserves, tax revenue volatility, pension funding gap)



Quality of Life Rankings | 2012-2022

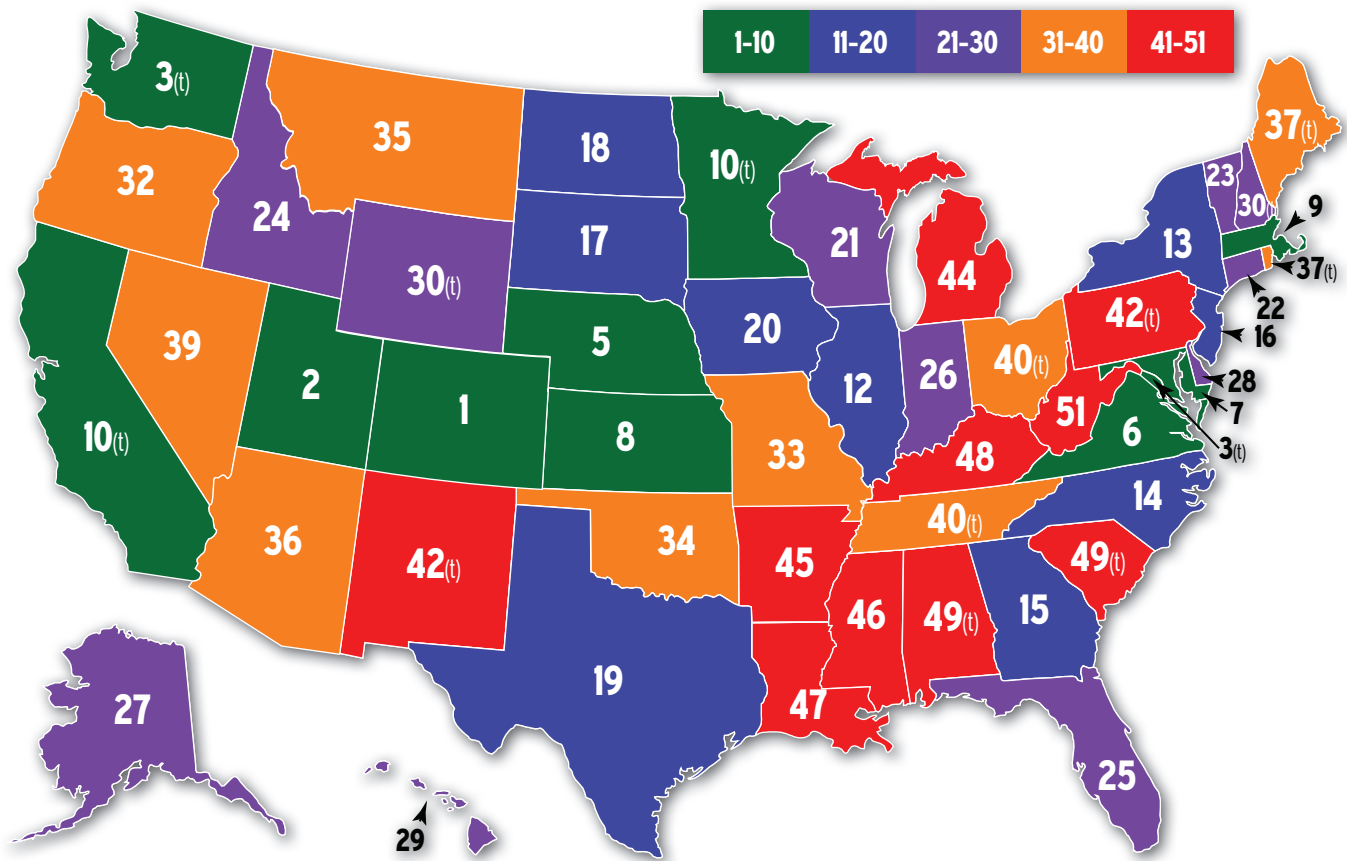


To determine the overall quality of life in each state, Morrison Street Research weighted factors including:

- Weather (month-by-month average high and low temperatures, precipitation and dew point)
- Traffic (peak hours of congestion per commuter)
- Crime (property and violent crime data)
- Number of Disaster Declarations since 1953



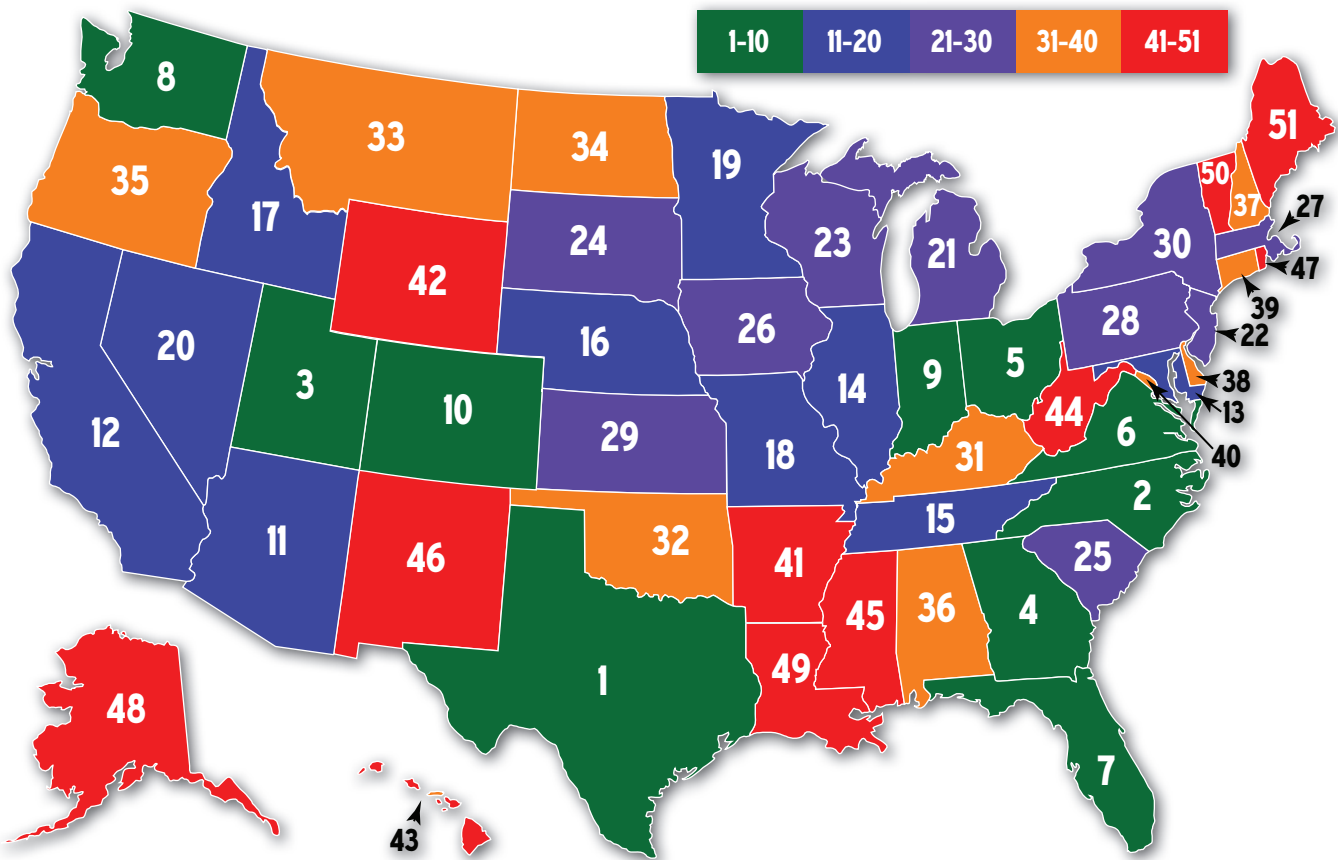
Demographic Rankings | 2012-2022



Demographic factors that affected the Morrison Street Research ranking of potential economic performance in a given state include:

- Pre-K through 12 Education Ranking
- Advanced Education Ranking
- Educational Attainment (college graduate percentage)
- Median Age (younger states favored for growth potential)

Overall Rankings | 2012-2022



The overall formula included a weighted ranking of the following number of factors in each category:

Population:	7
Employment Statistics:	5
Financial Statistics:	6
Quality of Life:	4
Demographic Statistics:	4
TOTAL:	26

SUPPLEMENT

Due Diligence

A properly trained investment team should perform multiple layers of due diligence before proceeding with each investment. That diligence process can be broken down into four major categories:



Market Study: an analysis of demographic trends, economic drivers, employment outlook, supply and demand characteristics of the relevant property type, a comprehensive analysis of the property's competitive position in its broader market and local submarket. The market study should include consideration of relevant environmental risks specific to the property's location and its broader geographic area including probabilities for flood, wildfire, tornado, hurricane, and disruptions to availability of power or water.



Borrower / Sponsor diligence: an analysis of the sponsor entity including its capitalization, expertise of the management team, investment and asset management personnel and process, past performance, and background checks (legal, financial and reputational) of key members of the borrower/sponsor.



Property due diligence: Audit of the property's historical financials, the budget and future financial projections. Review of the property's rent roll, operating expenses, contracts, leases, and tax assessments. Include a report on the physical condition of the property, a study of the environmental risks that impact (or may impact) the property directly or indirectly, a study

of the seismic strength of the property and flood risk if warranted by the local area and/or property condition. Investors should also consider the property's access to energy, water and emergency services. Investors should seek to put in place appropriate levels of general property insurance, with typical casualty coverage for most assets, and special coverage for increased risks in a given location (i.e. a separate policy for fire, flood, seismic, environmental conditions, or terrorism).



Price/Investment Basis: a comparison of the subject property's price and/or investment basis compared to replacement cost and comparable sales within the subject market and in relationship to alternative investment

geographic locations. Does the price or investment basis fully account for the economic risks, including those posed by climate change?

The combination of those four focus areas (Market, Borrower/Sponsor, Property and Price) help determine which investment tool to use in a given situation – preferred equity, bridge loan, structured equity, mezzanine loan, B note, or equity. Additionally, the complete evaluation of these four key factors does allow for identification of the primary risks to each investment posed by continued climate change and/or catastrophic events. Taken together with broader economic and climate considerations, each property's specific location, condition, age and construction will help determine the overall level of potential exposure.

Following identification of the primary environmental factors or natural hazards that could impact an investment, specific risk management techniques might include a combination of asset-level insurance, Fund-level insurance, and investment structure (e.g. sponsor guarantees/recourse, equity subordination, reserves, etc.). In rare cases, certain mitigation or adaptation techniques may apply, such as flood management

systems (levees, seawalls), earthquake retrofitting, and landscape management to reduce fire risk. These types of mitigation techniques may involve consultation with insurers to confirm the impact on cost and availability of ongoing insurance coverage. A thorough analysis should also consider local policies, laws and regulations that may positively or negatively impact the subject property. Of greatest concern is that as time passes, the cost and availability of property insurance could be affected in cities impacted the most by climate change and other natural hazards. In the case of specific properties or areas where there might be uncertainty surrounding whether insurance would remain available and affordable during the desired holding period, prudent investors should decline to invest.

Of paramount importance to the risk analysis is the expected holding period of a given investment or portfolio of investments. We should all be mindful of the longer-term risks of climate change and other natural hazards. Over a shorter-term investment horizon of 5 to 10 years, investors should target assets in the path of growth, and should not broadly redline potentially exposed geographies (other than very low-lying areas and those especially prone to fire) since the markets most at risk from climate change are precisely the markets currently growing at the fastest rates and which have the most potential for value appreciation.

As a result of lifestyle advantages, lower taxes and currently favorable climates, in recent years Southeastern coastal states have experienced strong increases in population and jobs. Investors with a longer-term view of portfolio allocations may need to pay special attention to the risks posed to certain geographic locations by ongoing climate change.

