Urban Land Institute Chicago

2020 Real Estate Forecast

KEYNOTE

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2020 REAL ESTATE FORECAST: NATIONAL OUTLOOK

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2020 “Perfect Vision” Real Estate Forecast

I. GDP
   A. Business Investment
   B. Consumer Spending

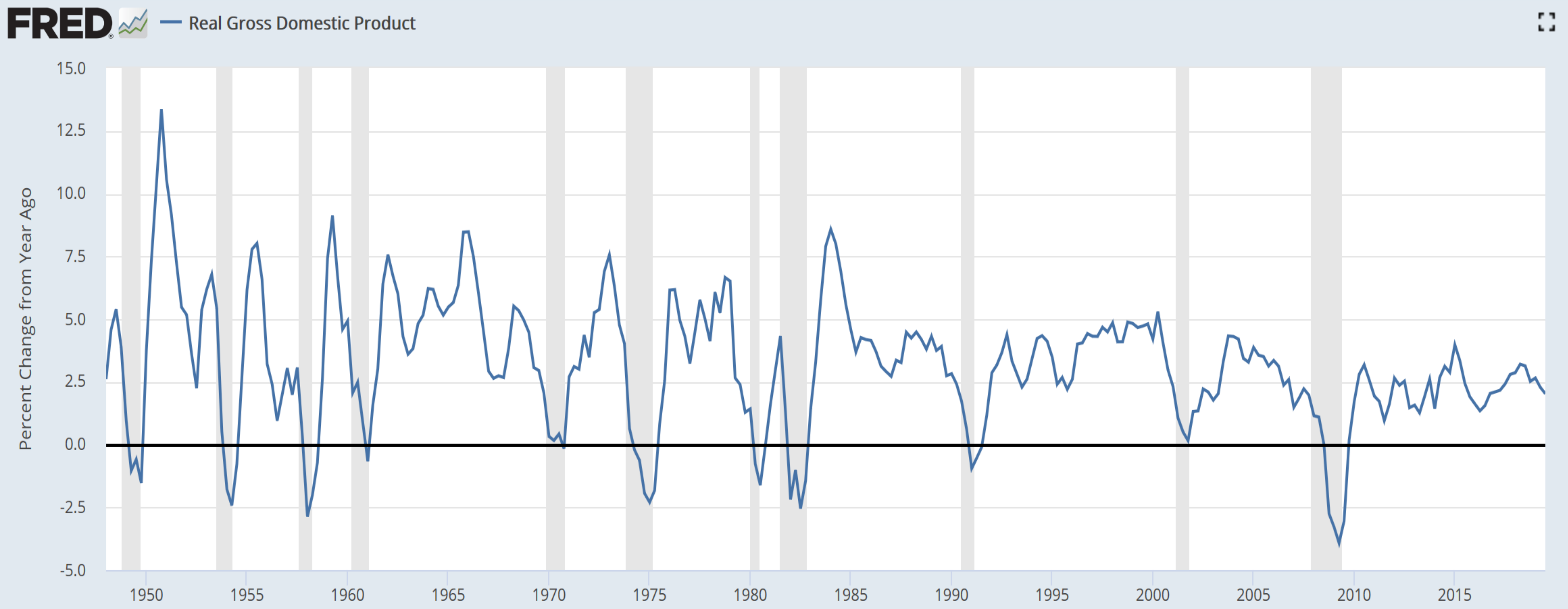
II. The Federal Reserve’s Decision
   A. The Phillips Curve
   B. Other Metrics

III. Capital Market
   A. Equity Markets and Property Returns
   B. Debt Markets

IV. Property Type Performance

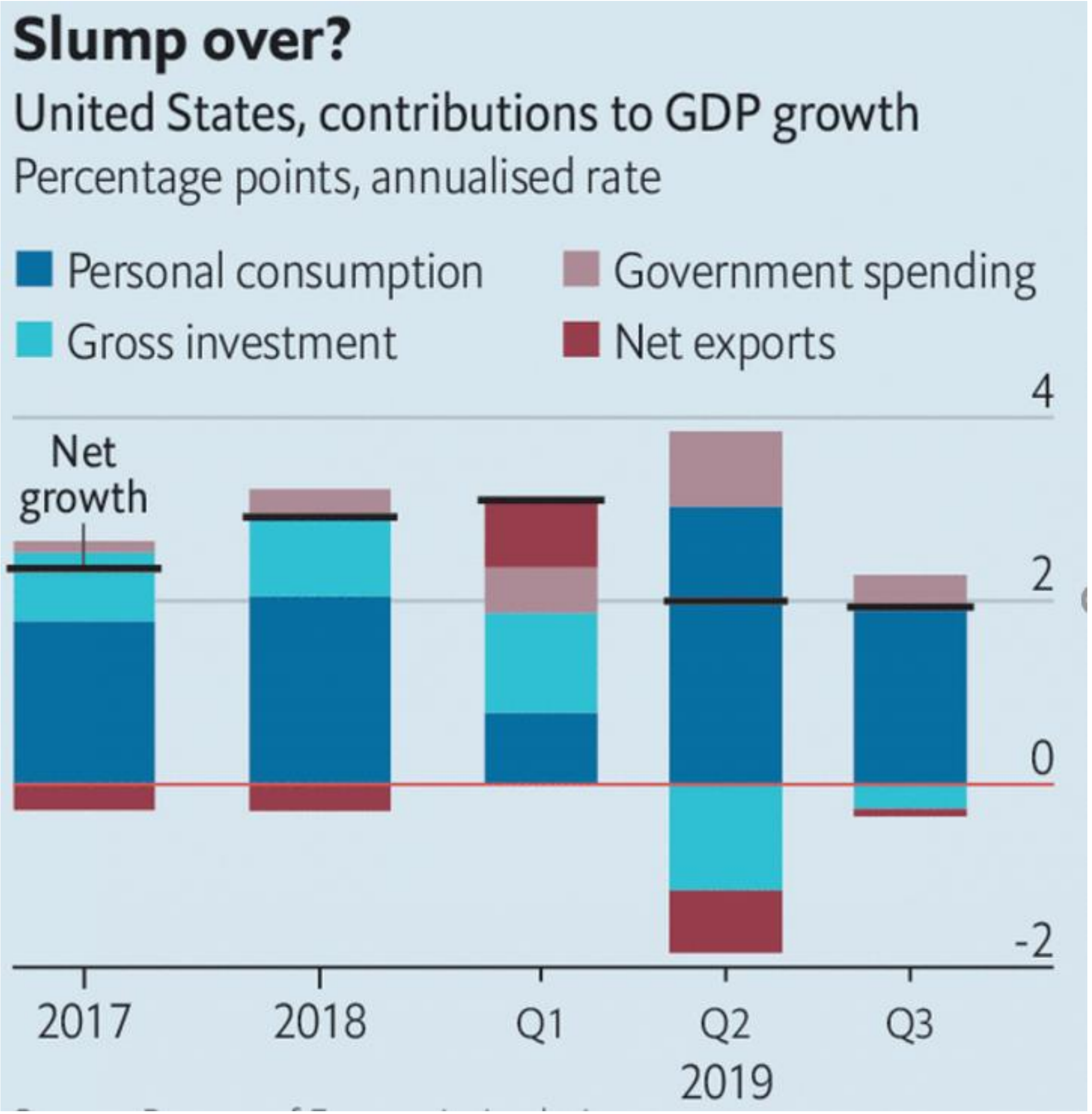

GDP
Gross
Domestic
Product
inventory
Investment
approach
component
implicit
includes
income
transfer
Purchases
produced
expenditure
output
economy
inflation
final
goods
Real
GNP
increase
country
Government
Nominal
Consumption
Exports
expenditures
important
price
services
growth
nation's
Sales
Approaches
measures
result
working
either
rendering
effect
purchasing
National
Economic
smaller
within
workers
three
located
size
market
deflator
measure
known
dividing
calculates
borders
Calculating
power
largest
value
adjusted
factors
number
calculated
imports
country's
described
larger
citizens
greater
Net
Note
payouts
population
subtracting
producers
spending
defined
possible
another
unemployment
follows
calculate
example
laws
practice
equal
minus
lower

GDP: 2.0% GDP growth, Y-O-Y to 2019Q3, however 0.66% of the increase is defense (0.27%) and State and Local Government spending (0.39%) . . . .



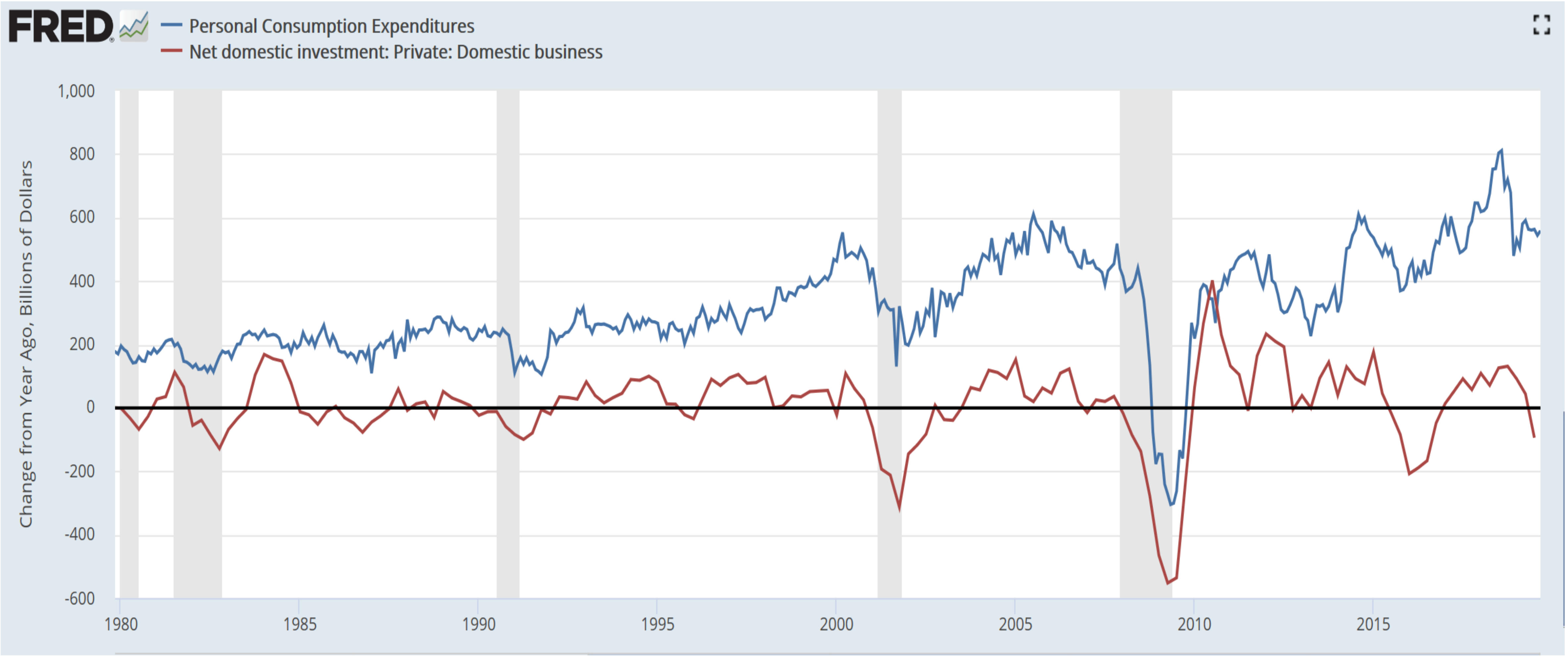
Sources: Federal Reserve Economic Data and Graaskamp Center

. . . . GDP: by its components. . . .



Source: Economist, “Corporate America’s Confidence and Profits are Sagging,” October 23, 2019

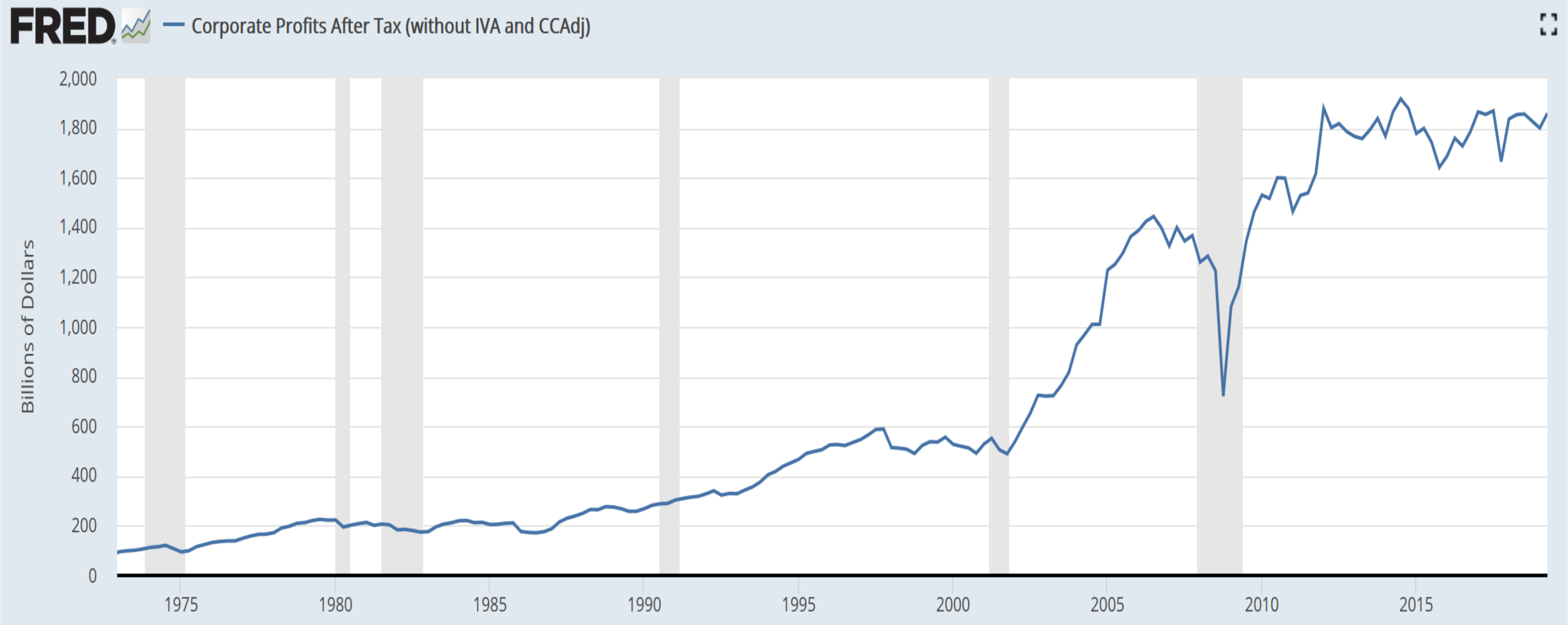
. . . . GDP: consumption remains robust as business investment wanes . . . .



Sources: Federal Reserve Economic Data

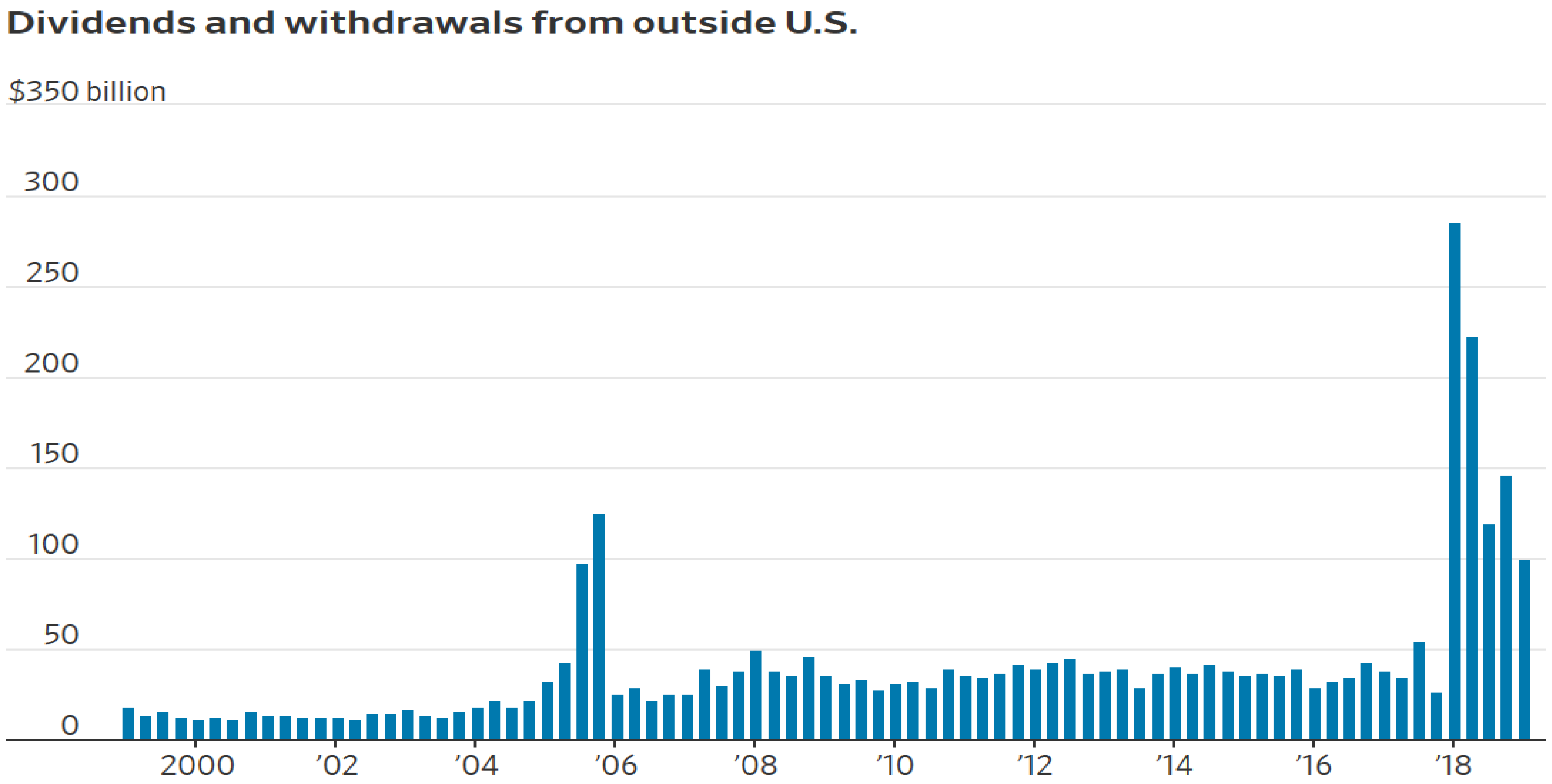

invest
industry
opportunities
product
strategy
analysis
identify
business
market research
success
distribution
weaknesses
weakness
market
potential
investigation
cost
area
information
statistics
discover
threats
finance
financial
definition
channels
opportunities
research
consumer
organization
strengths
potential

. . . . Business Investment: corporate profit has grown 18-fold since 1974, CPI 6-fold . . . .



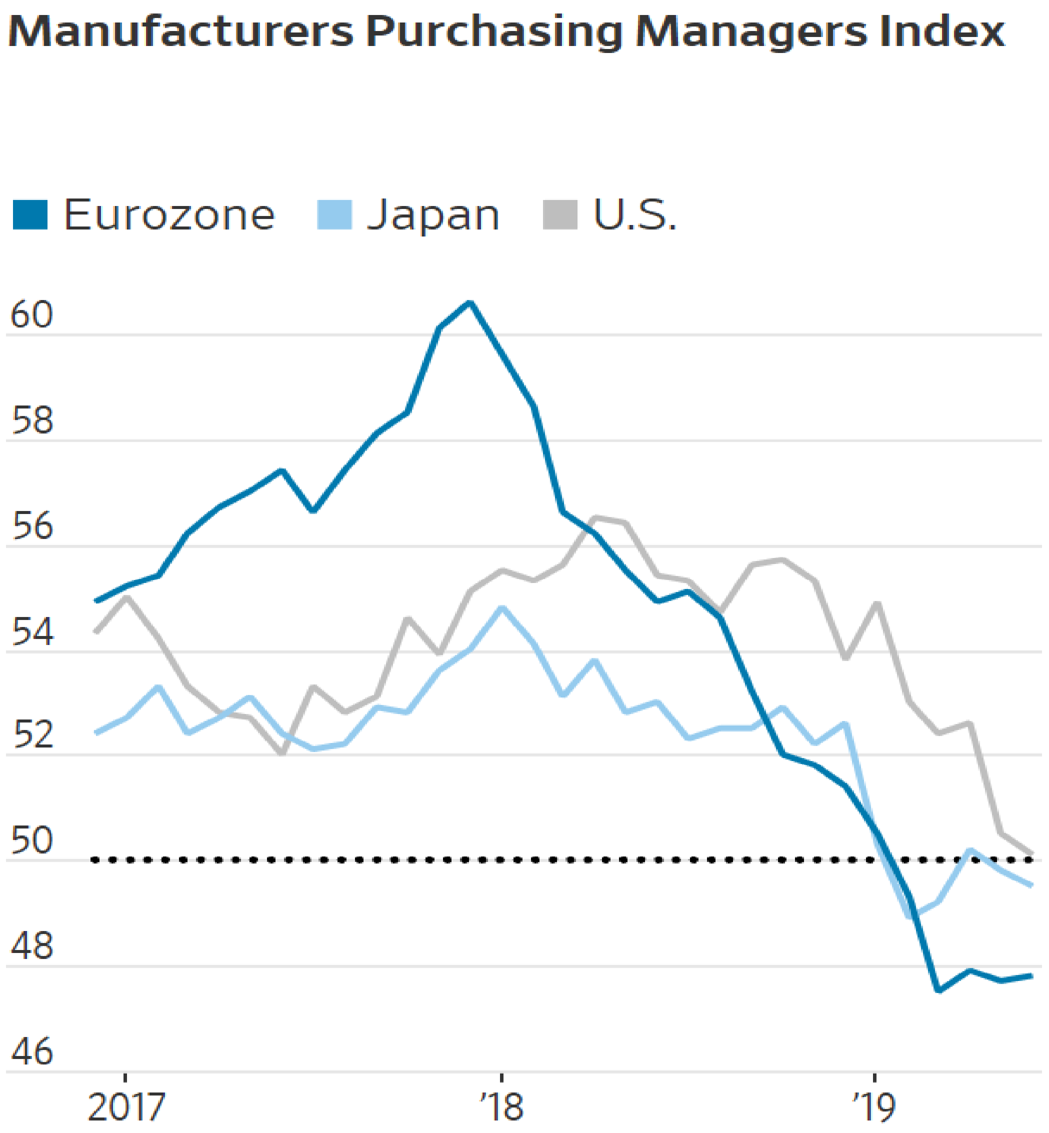
Source: Federal Reserve Economic Data.

. . . . Business Investment: large repatriated business profits from abroad, $777 billion in 2018, up from $155.08 billion in 2017. . . . .



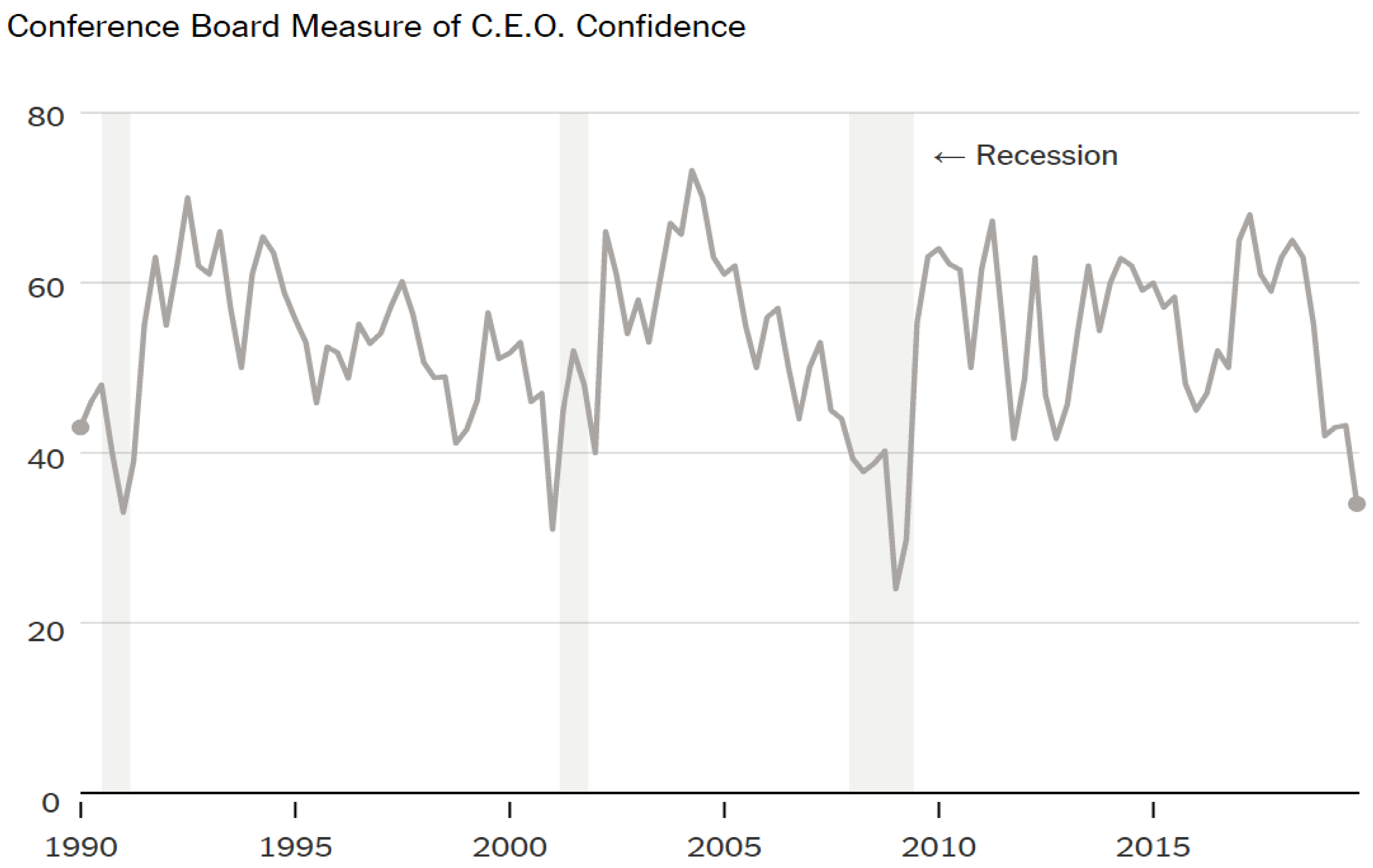
Source: WSJ, “U.S. Companies Brought Home More Proits From Overseas,” June 20, 2019

. . . . Business Investment: globally manufacturing is flagging . . . .



Source: WSJ, "Faltering Factories Cast a Dark Cloud Over Global Economy," June 21, 2019.

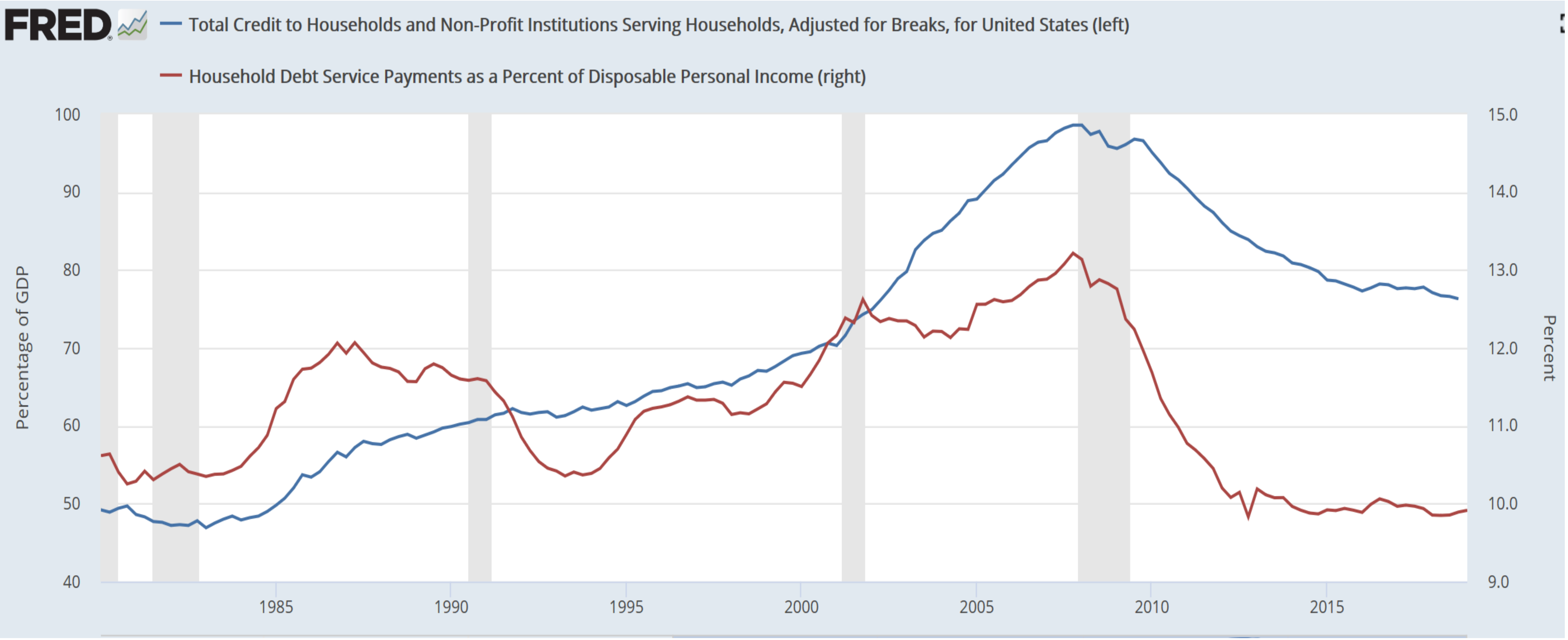
. . . . Business Investment: CEOs are not confident.



Source: Matt Phillips, NYTs, "CEOs are Anxious about the Economy and That is Bad for Stocks ," October 24, 2019

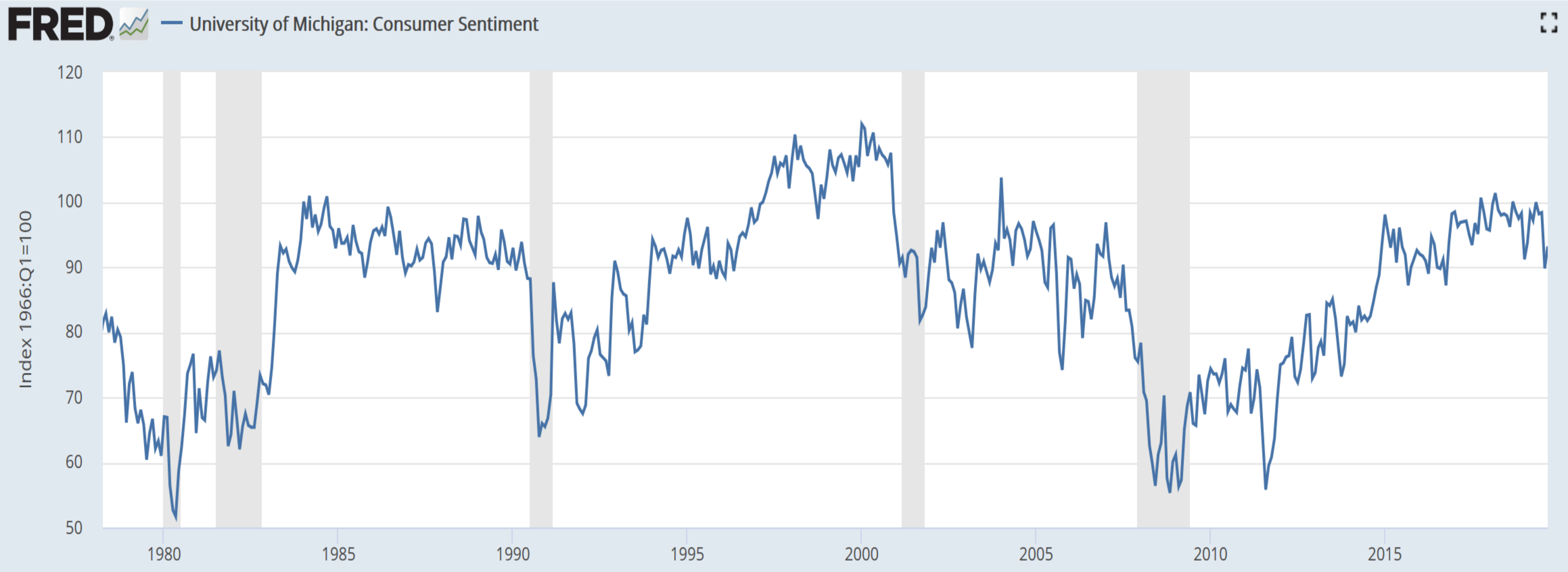
Consumer Spending

. . . . Consumer spending: however, consumers have debt service and debt capacity . . . .



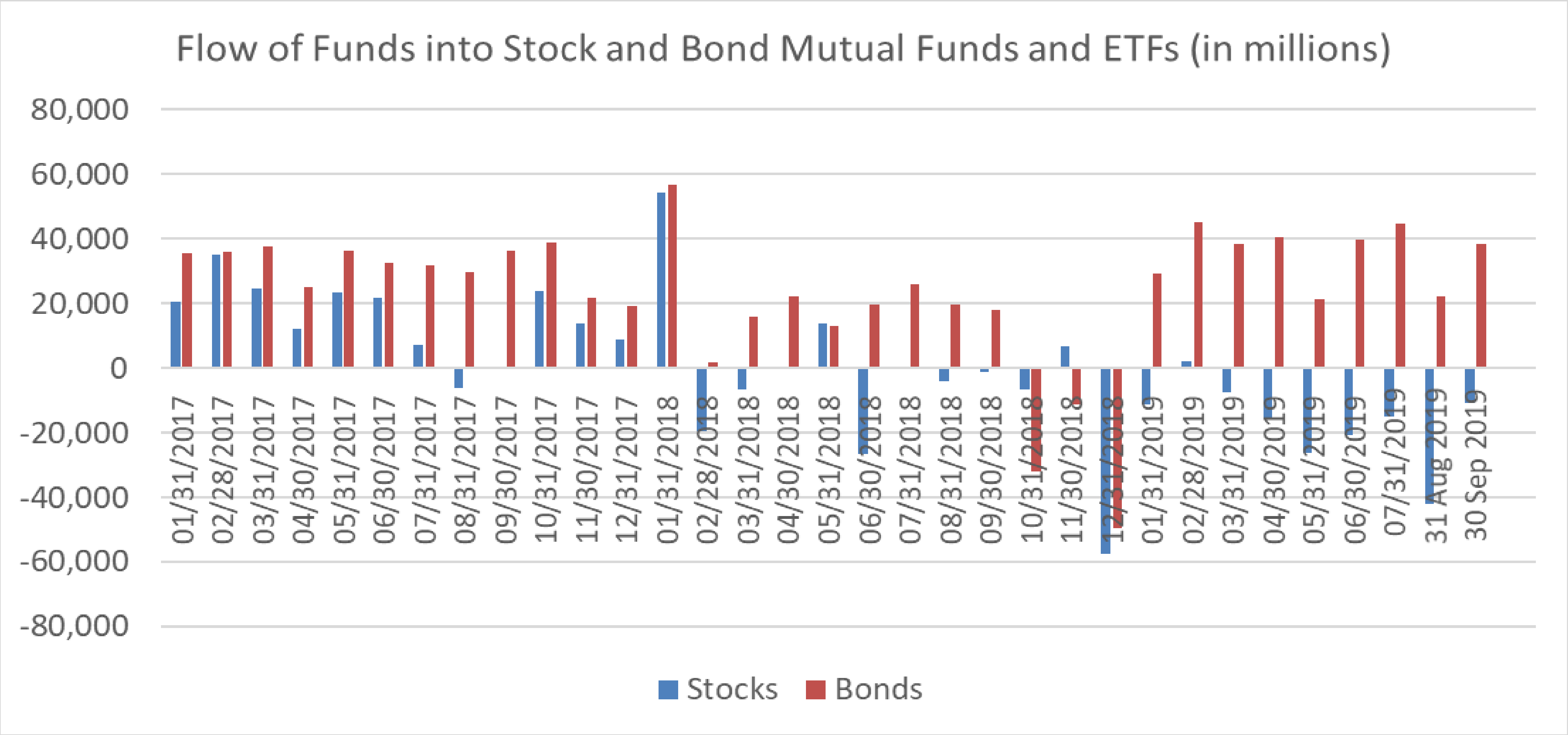
Source: Federal Reserve Economic Data.

. . . . Consumption: and consumer sentiment remains strong, but turns quickly.



Source: Federal Reserve Economic Data.

. . . . Consumer Spending: Consumers/Investors are taking less risk . . . .



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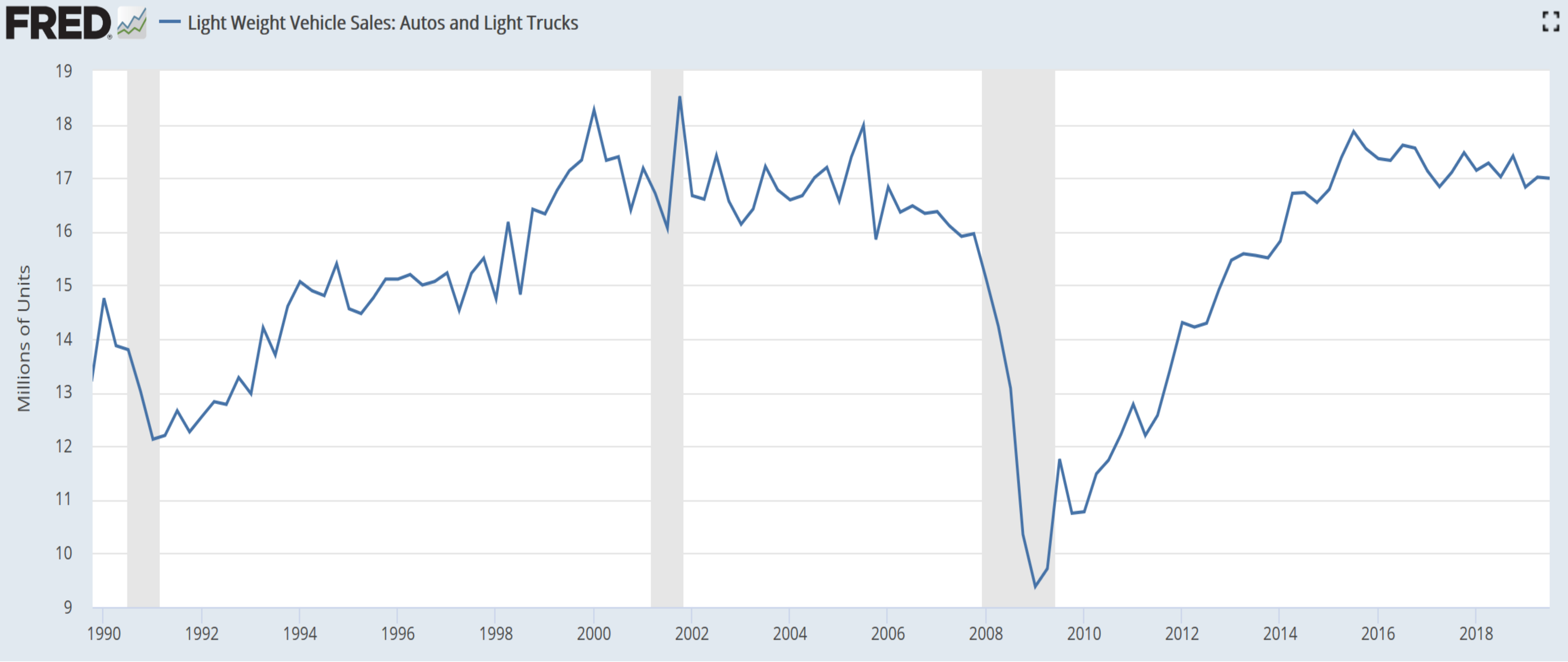
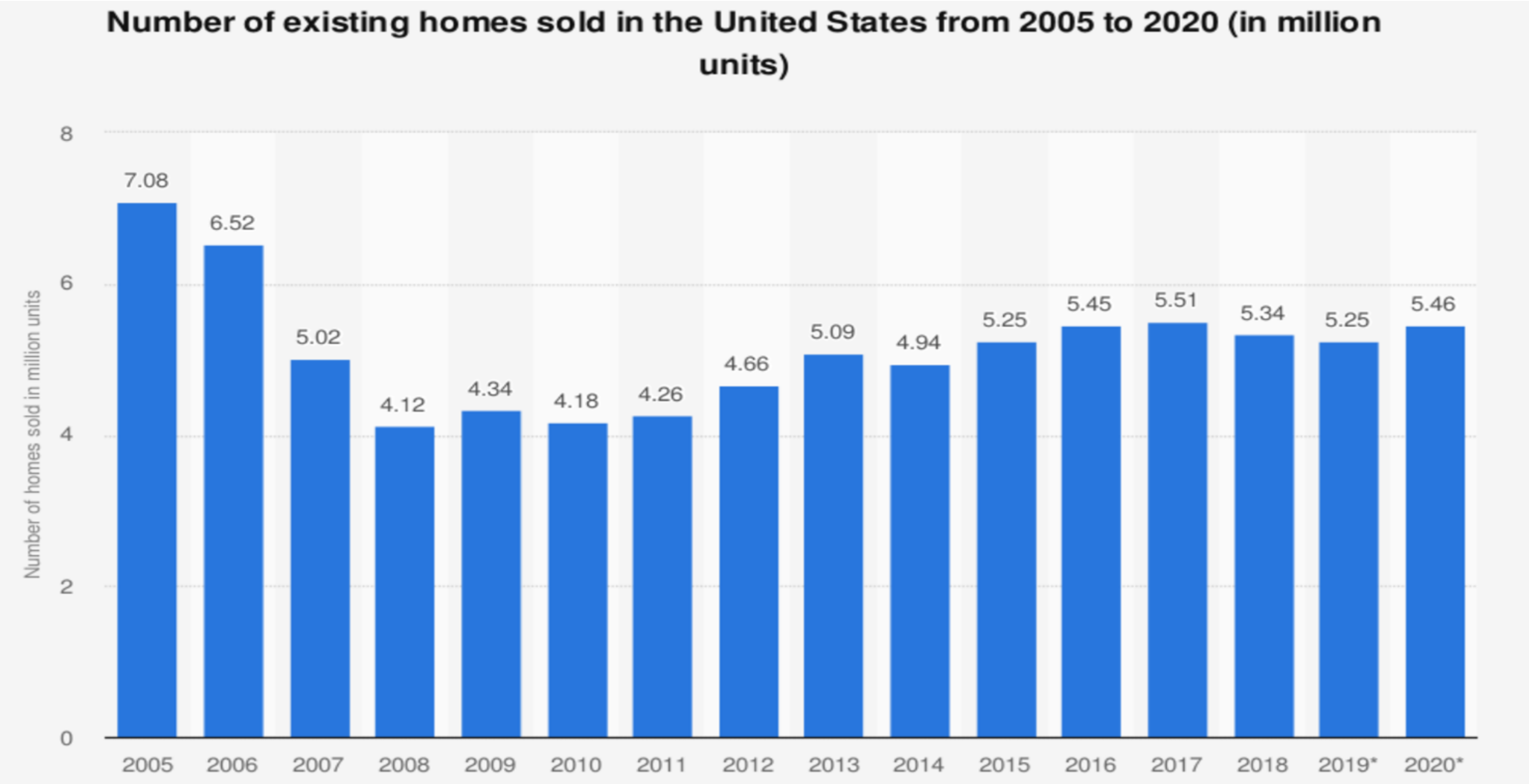
Source: Investment Company Institute and the UW Graaskamp Cent er for Real Estate.

. . . . Consumer spending: vehicle purchases peaked in 2015 at 17.9 million vehicles . . . .



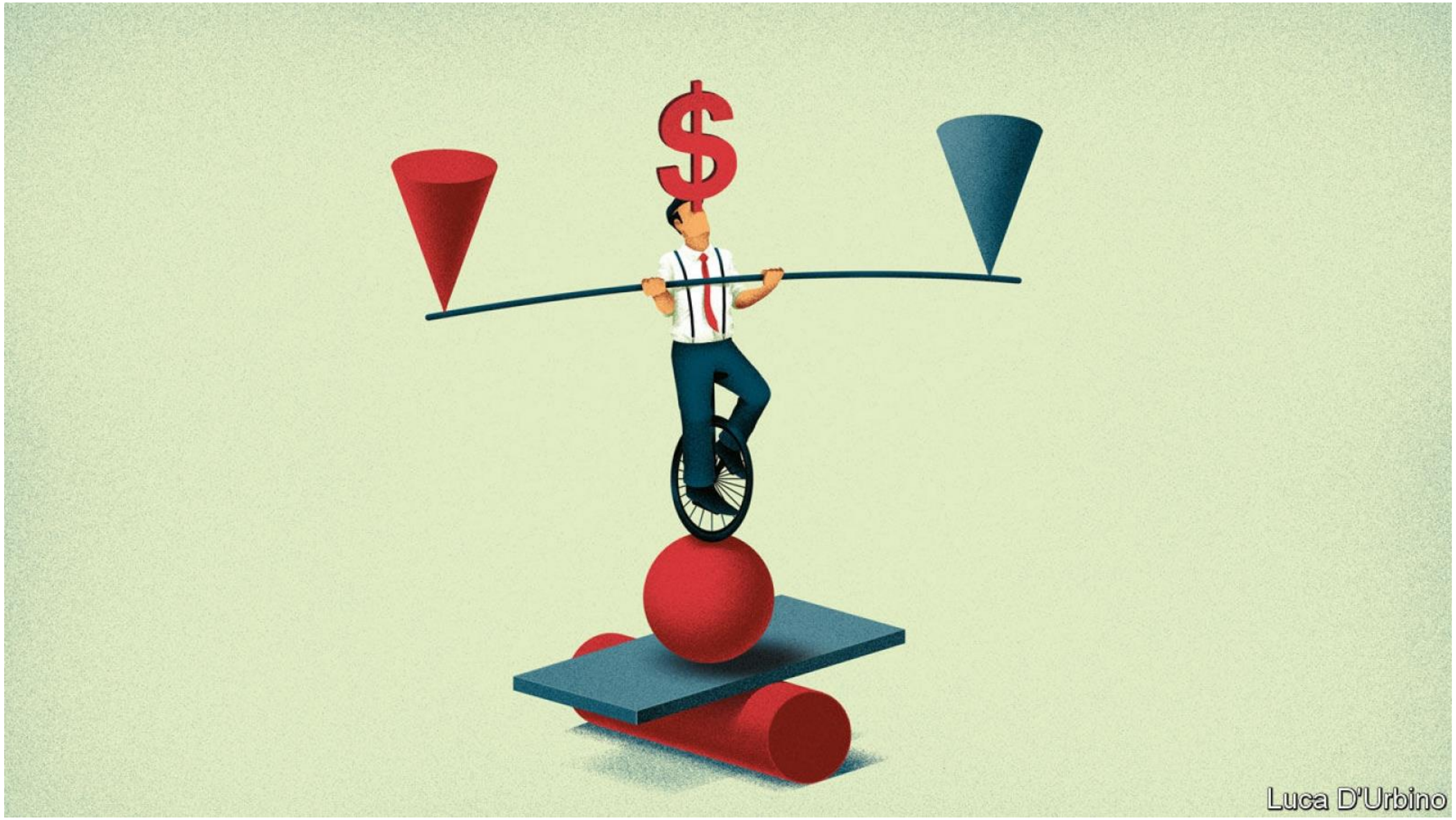
Source: Fannie Mae Credit Supplement, 2018Q4.

. . . . Consumer spending: consumers are limiting big purchases.



Source: NAR, REALTORS Confidence Index Survey, November 2018.

The Federal Reserve Decision



Source: Economist, "America's Economy is Reisting the Pull of Recession," October 31, 2019

The Challenge at the Fed. . . .

The Phillips Curve: The possibilities. . . .

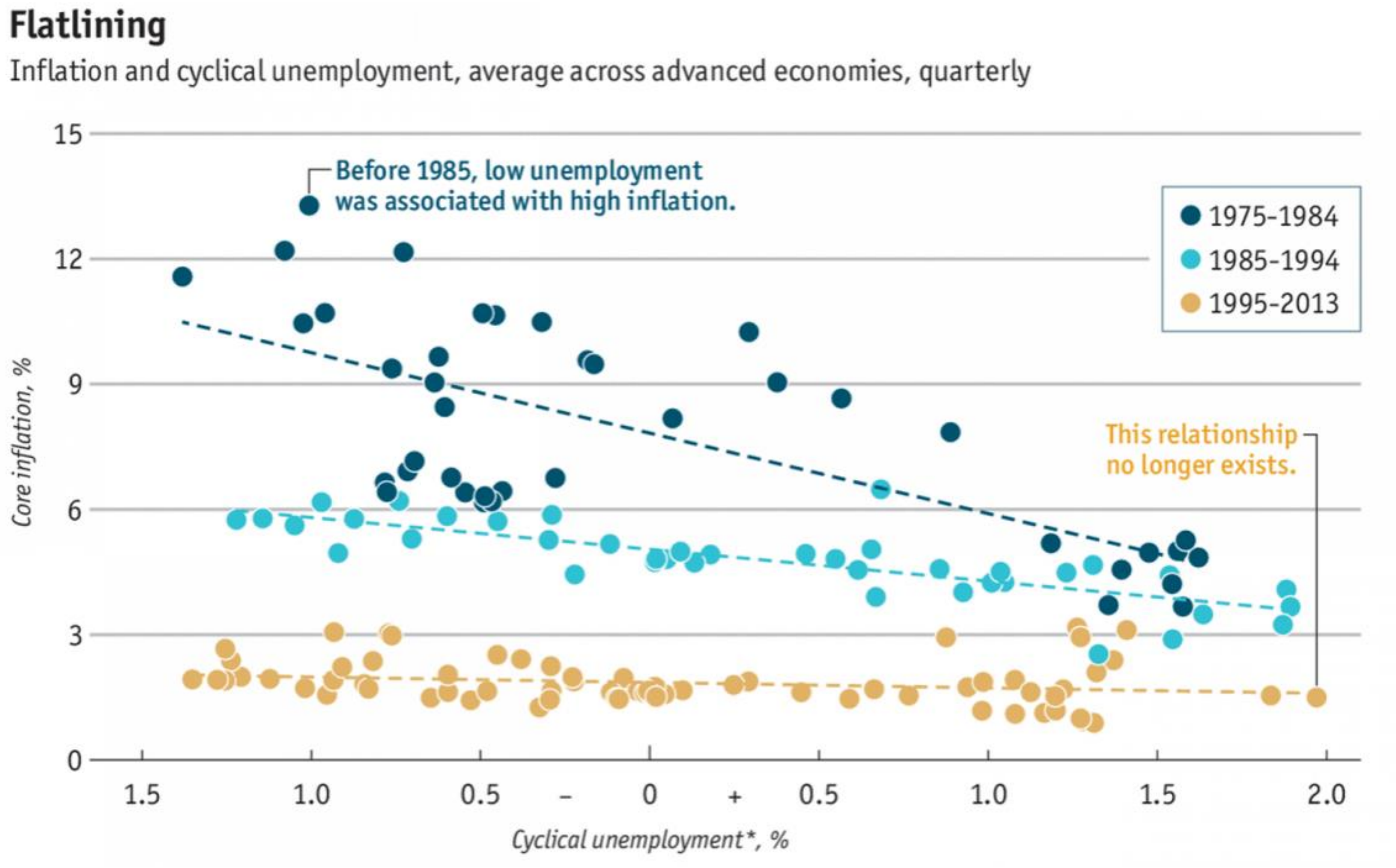
1. The Phillips Curve is and artefact: observed statistical relationships collapse once they are exploited by policy makers

2. Inflation expectations: the public's ability to anticipate or at least notice rising prices faster and adjust their expectations

3. The Phillips Curve is non-linear: the Phillips curve still exists and could suddenly and quickly accelerate if wages fall below a threshold

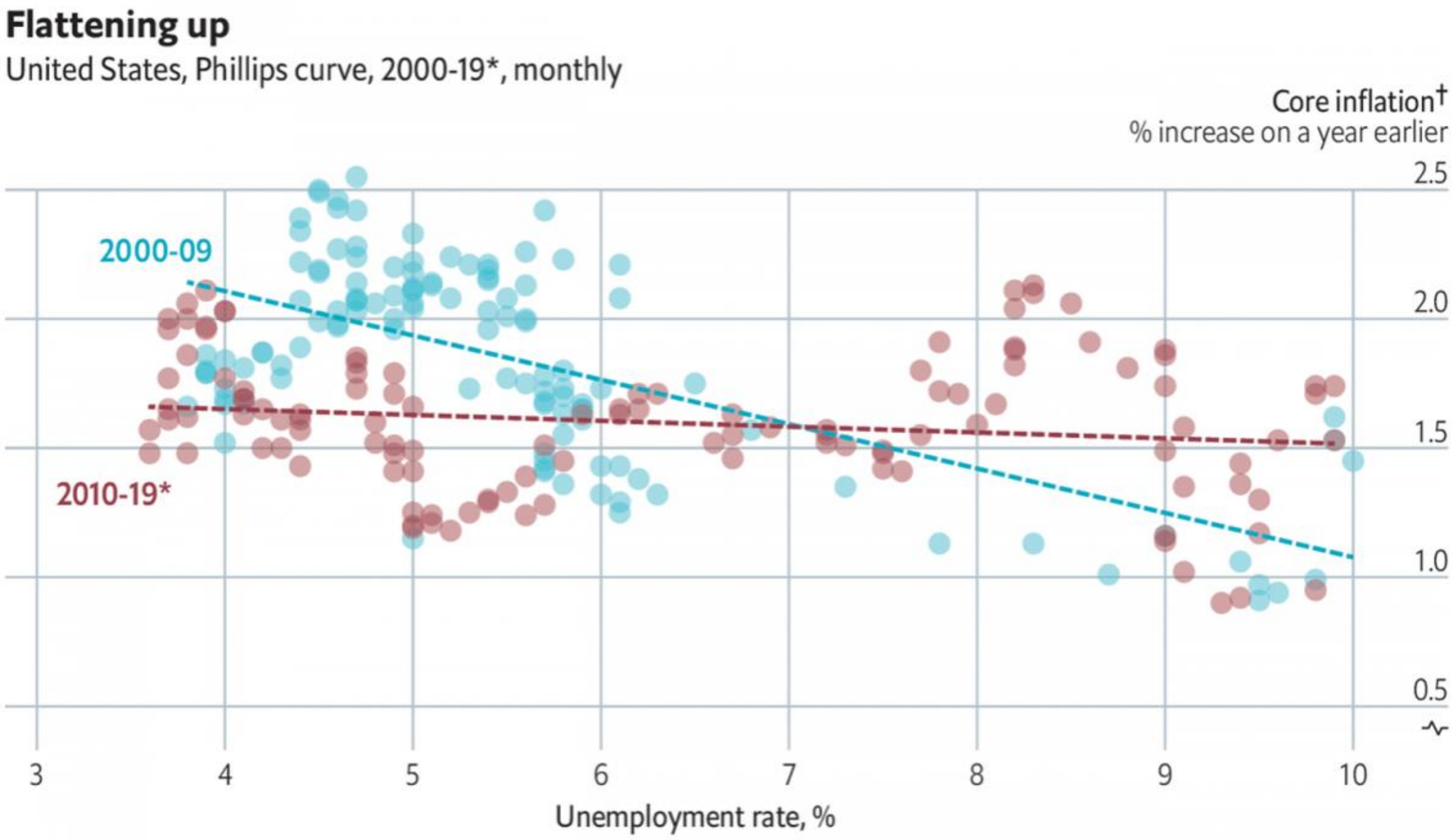
Source: Federal Reserve Bank, Wage Tracker and The Graaskamp Center.

. . . . #1, Artefact: Phillips curve is an artefact . . . .



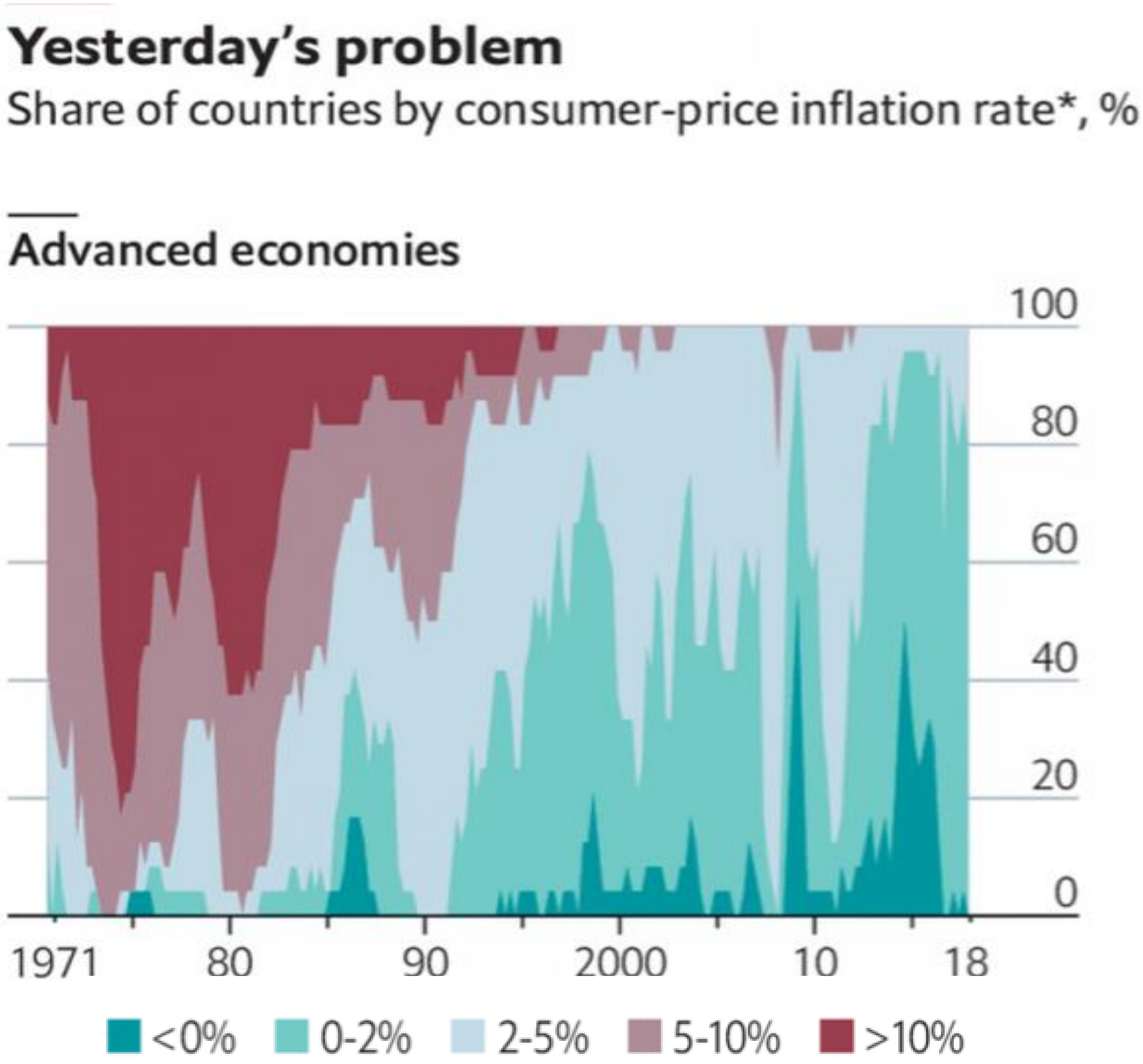
Source: Economist, The Phillips Curve may be Broken for Good, Novebmer 1, 2017

. . . . #1, Artefact: The Phillips curve is and artefact, version 2 . . . .



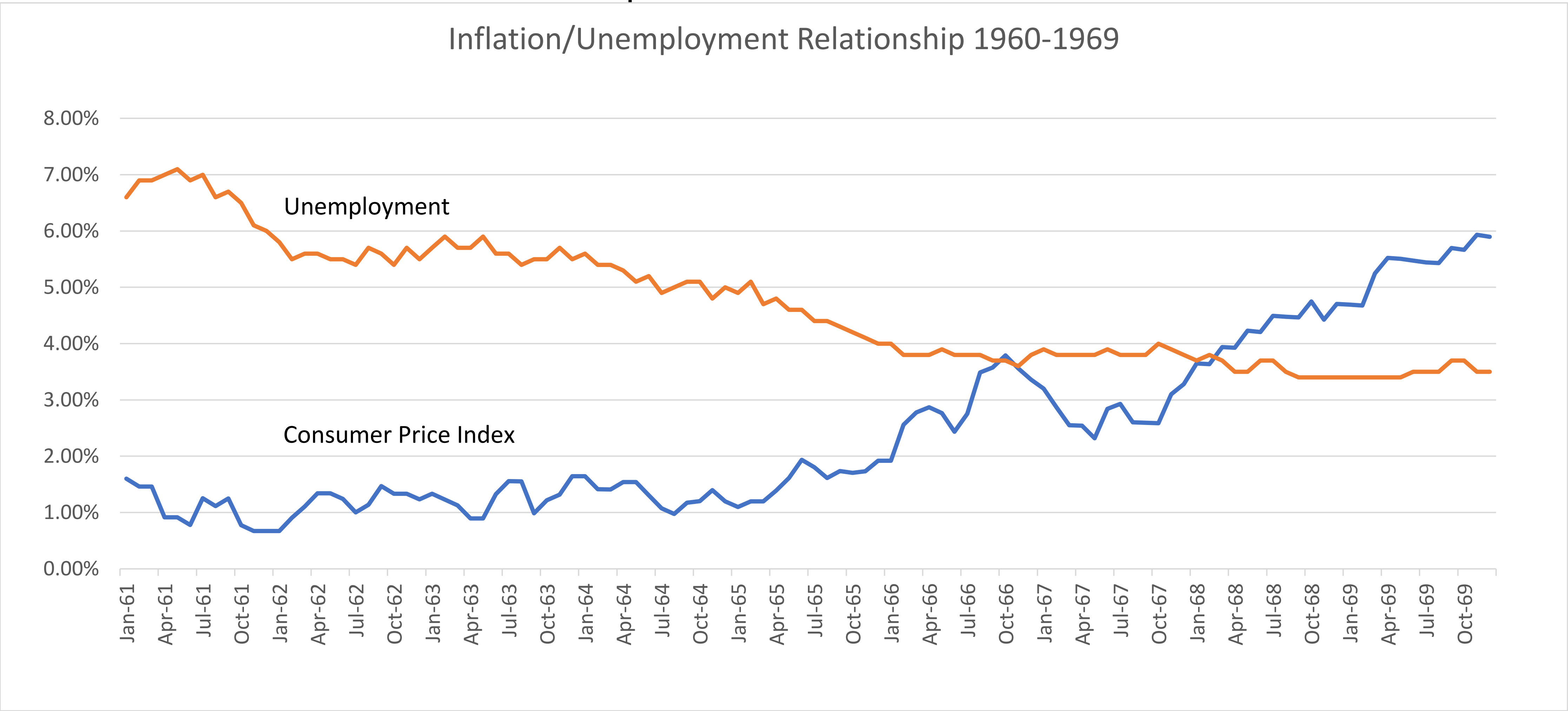
Source: Economist, “Finding Phillips,” October 10, 2019.

. . . . #2, Inflation expectation: Businesses and the public better anticipate price increases, and the labor market is global. . . .



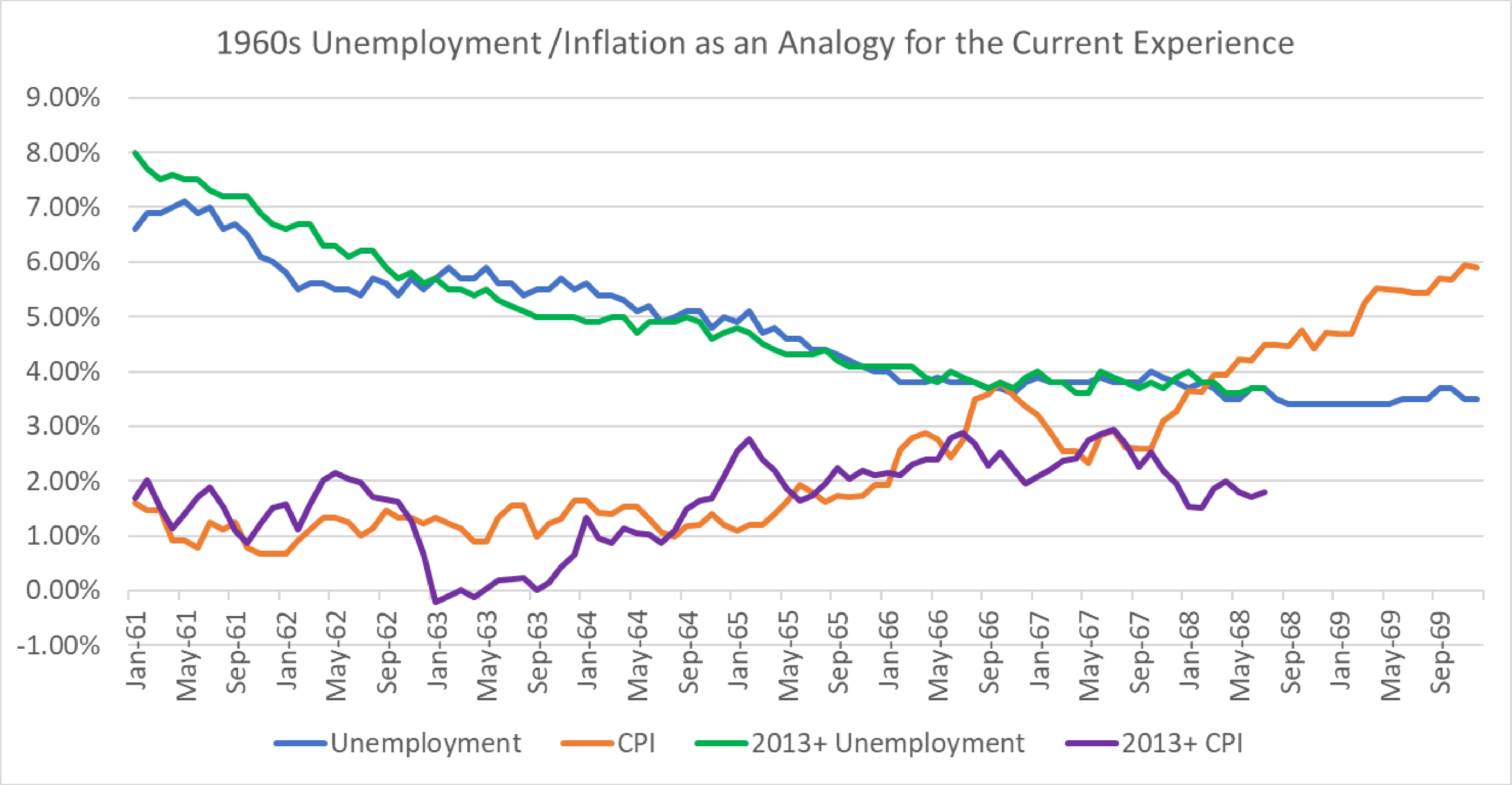
Source: Economist, "Inflation is Losing its Meaning as an Economic Indicator," October 10, 2019

. . . . #3 Non-Linear: the Fed unemployment/inflation trade off – the 1960s experience. . . .



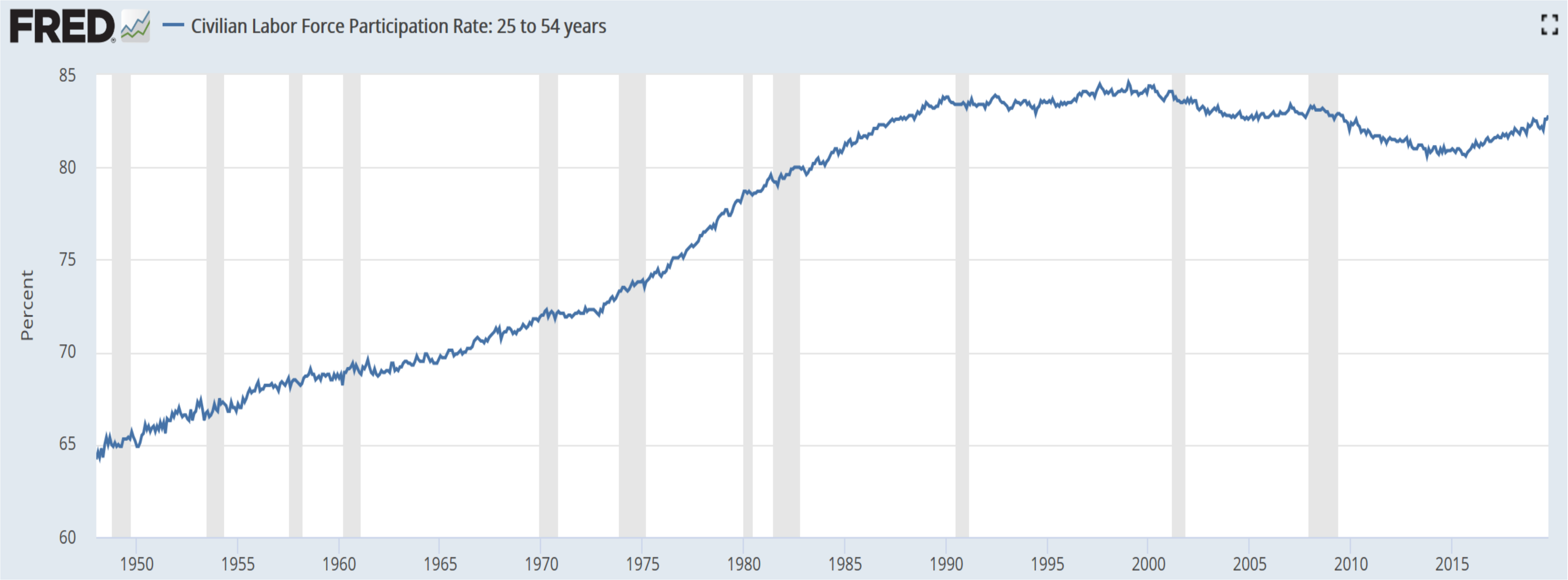
Sources: Federal Reserve Economic Data and the Graaskamp Center.

. . . . #3 Non-Linear: comparing the 1960s with the current environment . . . .



Sources: Federal Reserve Economic Data and the Graaskamp Center.

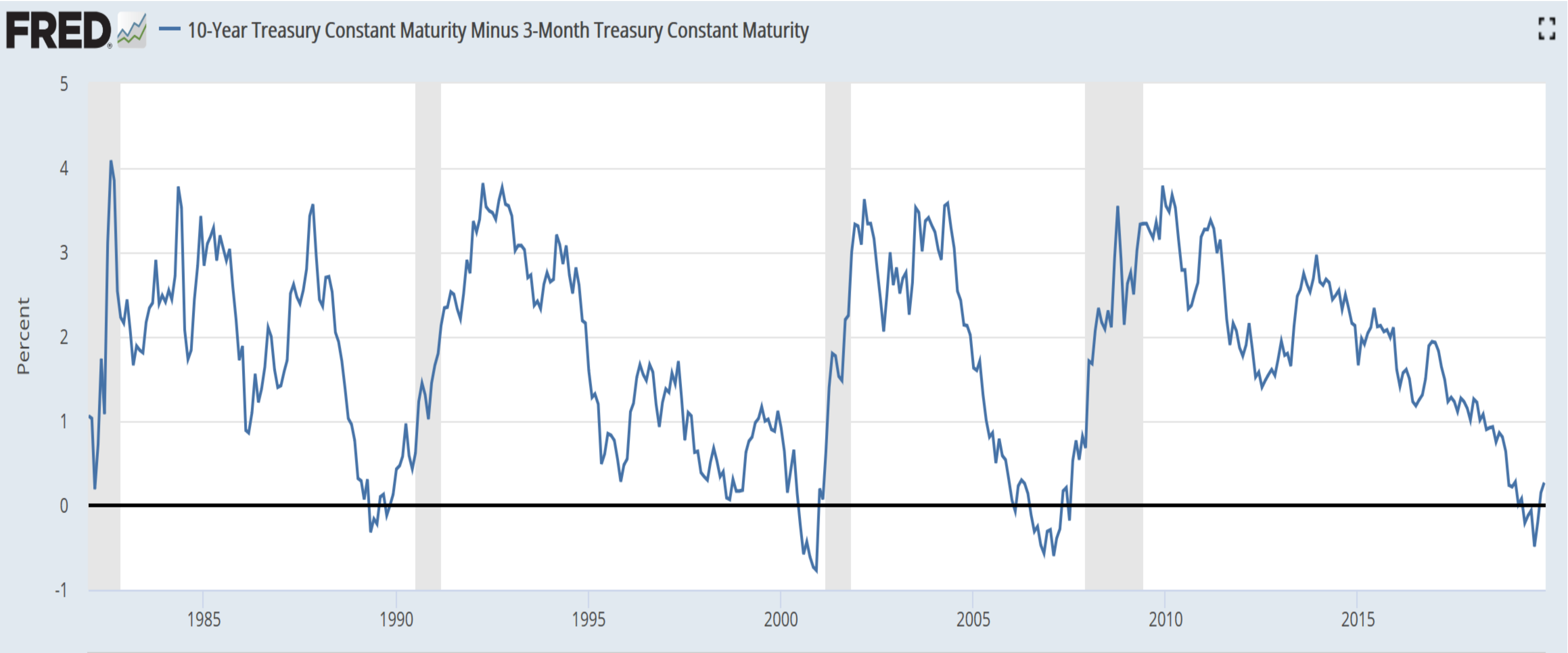
. . . . Adjusted labor force participation rates are at mid-2000 levels.



Source: Federal Reserve Economic Data.

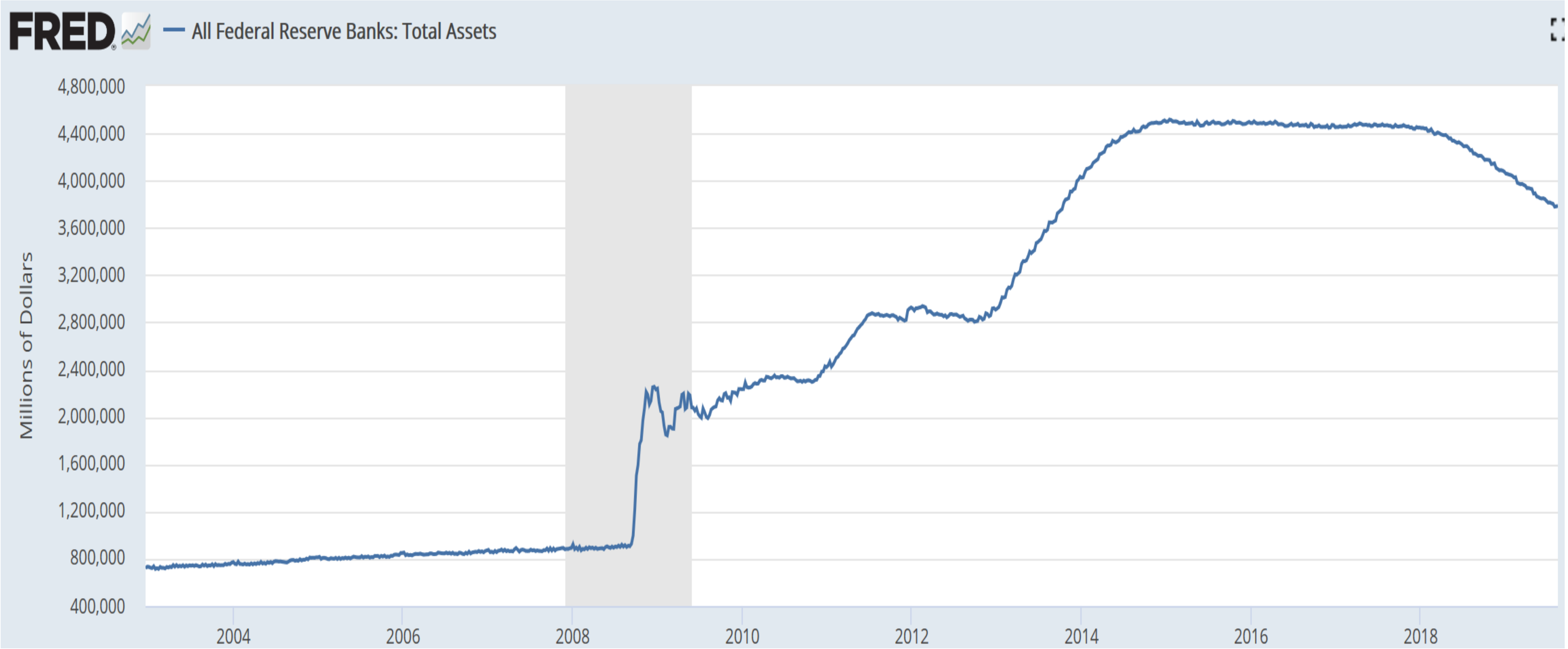
Other Important Federal Reserve Considerations/Actions

The inverted yield curve (10 yr. less 3 mo. UST), a solid a recession predictor . . . .



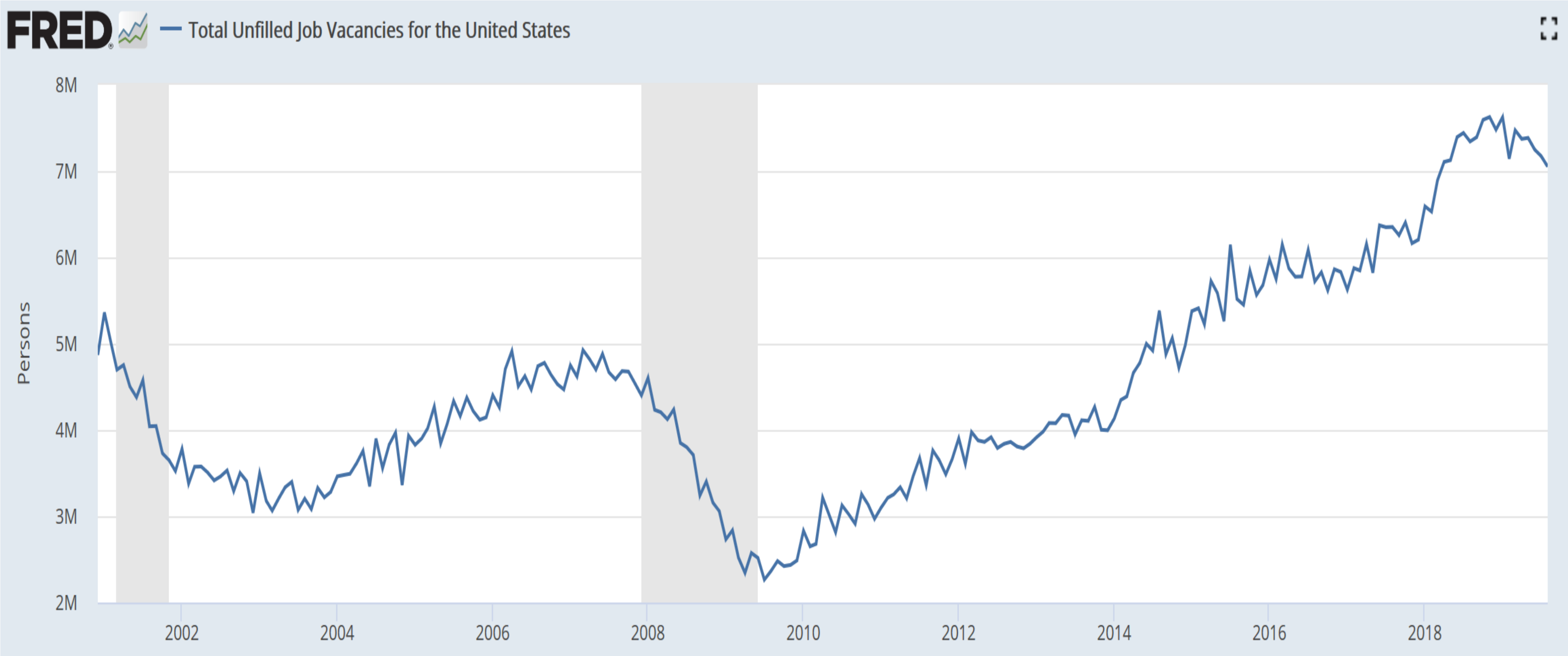
Source: Federal Reserve Economic Data.

. . . . Quantitative Tightening of $50 billion per month will end in September 2019 . . . .



Sources: Federal Reserve Economic Data

. . . . unfilled job vacancies peaked in November 2018 . . . .



Source: Economist, “Corporate America’s Confidence and Profits are Sagging,” October 23, 2019

The Global Economy and Trade

. . . . the China/U.S. trade deficit, currency manipulation, and Iran sanctions . . . .

. . . . Hong Kong unrest and China debt-fueled growth (150% of GDP in 2009 to 250% today) . . . .

. . . . Brexit? Germany's weak economy? The EU? What could possibly go wrong . . . .

. . . . U.S. consumer get spooked, import prices/tariffs, market volatility, etc.

Source: Economist, October 13-19, 2018

GDP/Federal Reserve Decision Summary

I. GDP

- Business Investment will remain be narrowly negative in 2020
- Consumer Spending usually follows Business Investment
- Consumer Spending is unlikely to have a significant trigger event
- Outcome: GDP will migrate from 2.0% to 1.0% across 2020

II. The Federal Reserve's Decision

- The Phillips Curve haunts Federal Reserve leadership and economist
- Global labor markets and supply chains broke that relationship
- Solid consumption with weak investment and global demand
- Outcome: Federal Reserve actions will be limited, with continued accommodation the likely next moves

Source: Federal Reserve Bank, Wage Tracker and The Graaskamp Center.

Real Estate Capital Markets

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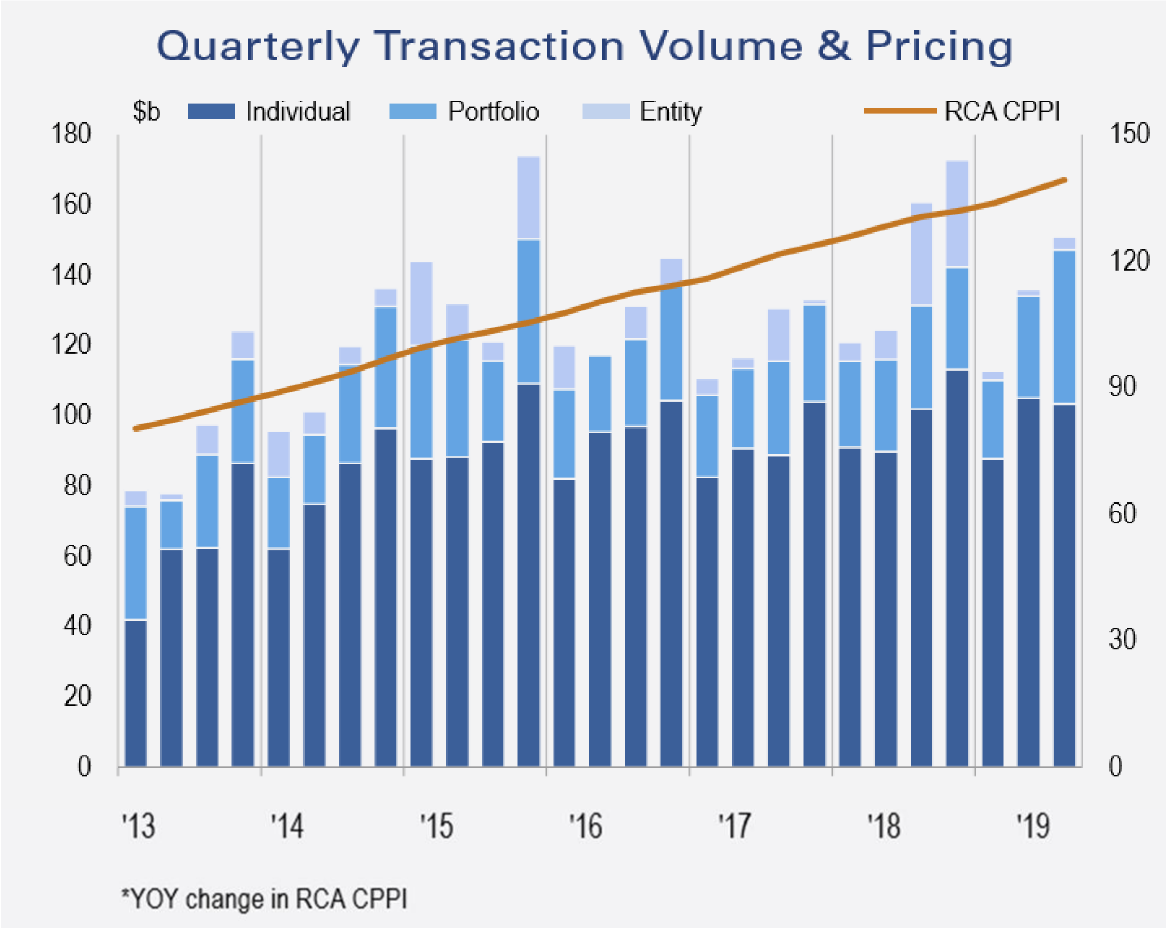
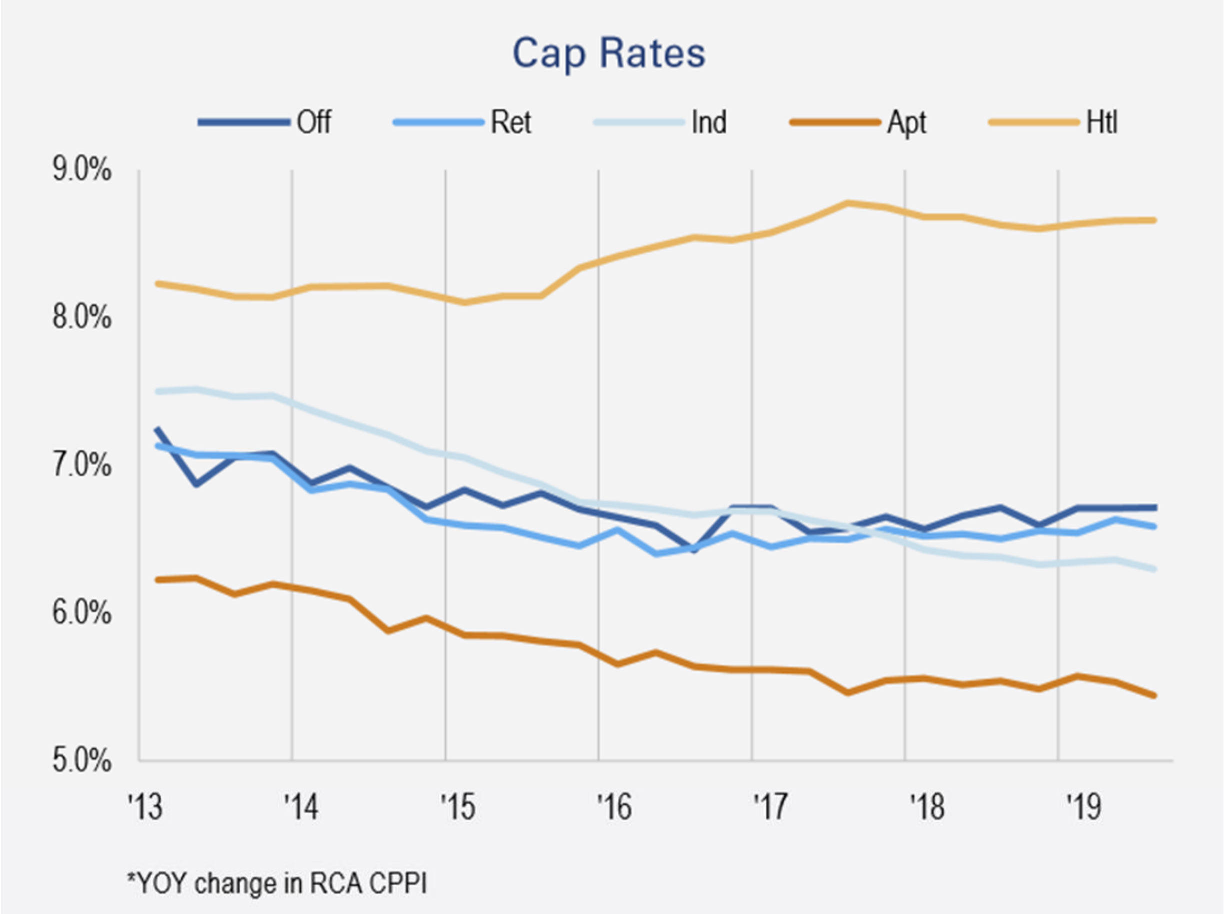
Equity Capital Markets and Property Returns

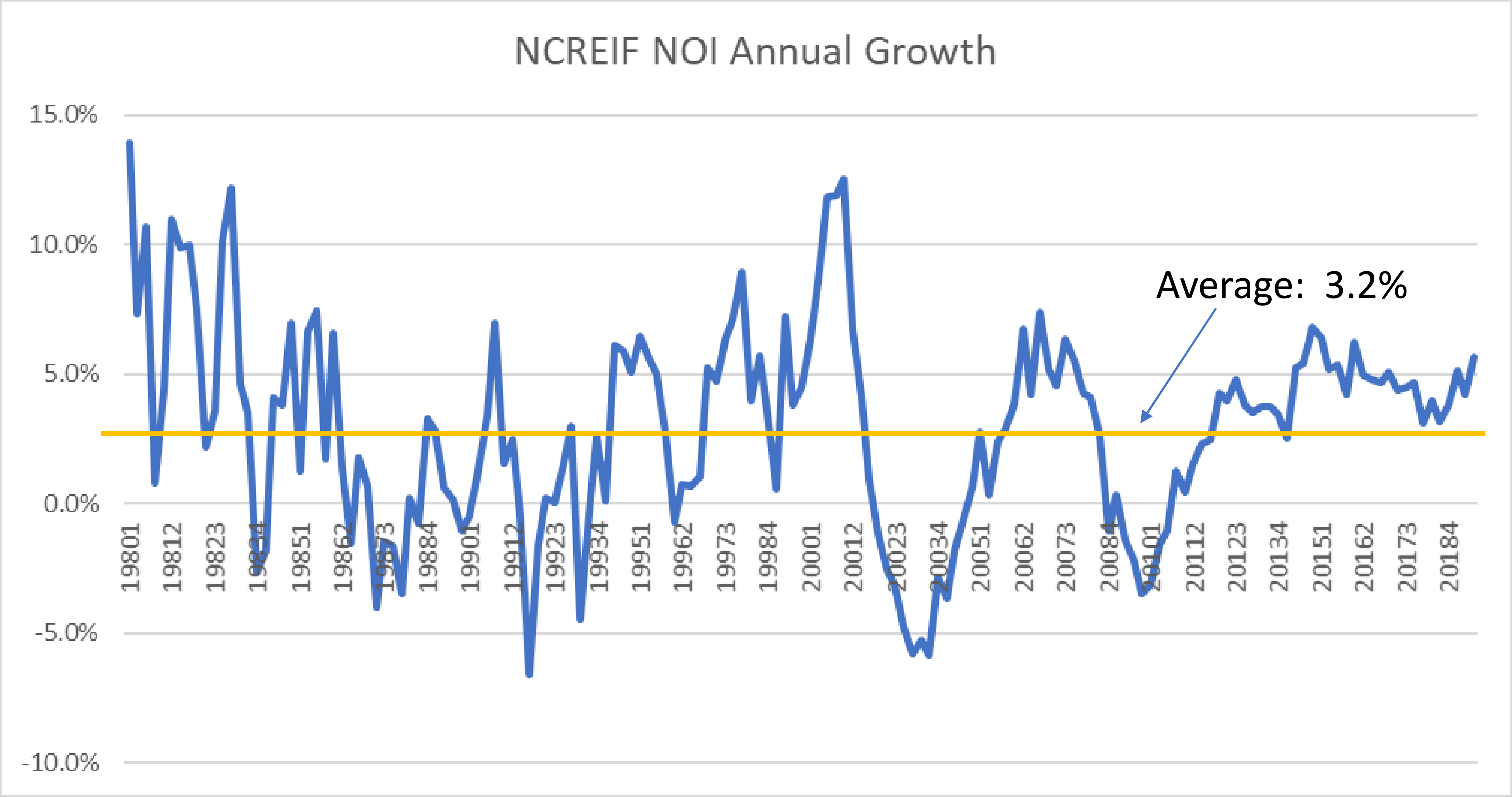
Real estate transaction volume off 6% YOY, cap rates remain stable . . . .





Source: RCA, US Capital Trends: The Big Picture, 2019Q3.

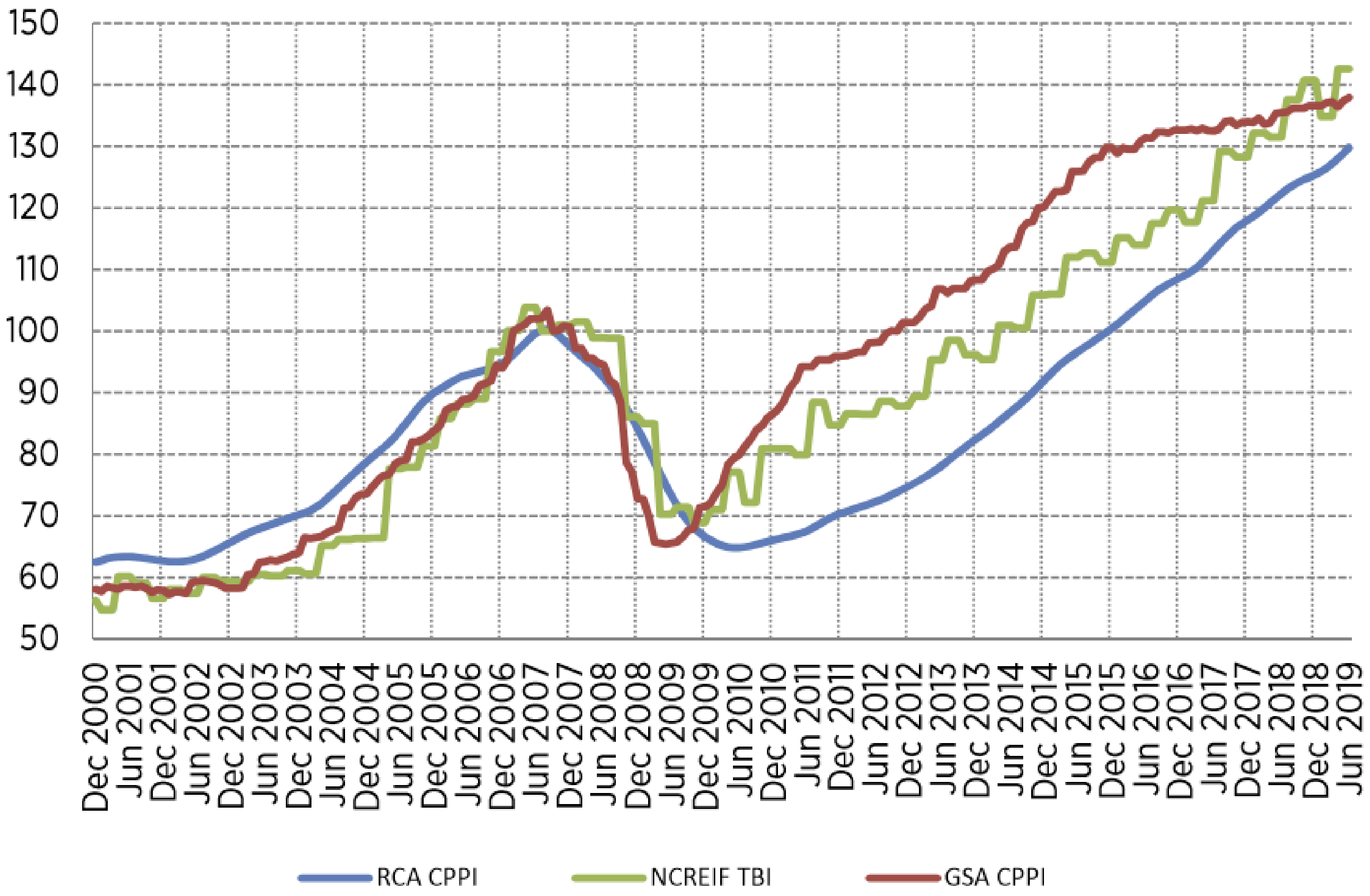
. . . . property income growth remains robust, sans retail . . . .



Source: NCREIF and the Graaskamp Center.

. . . . . three-year property price appreciation rates range from 2-8% per annum depending on which index you believe. . . .. . .

Commercial Property Price Indices



Source: Mortgage Bankers Association, Commercial/Multifamily Databook 2019Q2.

. . . .property returns are stable and competitive . . . .

Market Index Comparisons (through 2019Q2)

	1 Year	5 Year	10 Year	20 Year
National Property NCREIF Index, (no leverage)	6.5%	8.8%	9.3%	8.9%
S&P 500 Index	10.4%	10.7%	14.7%	5.9%
NAREIT (averages 35% leverage)	12.6%	8.8%	16.0%	10.6%
T-Bills	2.1%	1.0%	0.5%	1.9%
CPI	1.7%	1.5%	1.7%	2.2%

Source: NCREIF Real Estate Performance Report, 2019Q2
,
and Graaskamp Center for Real Estate.

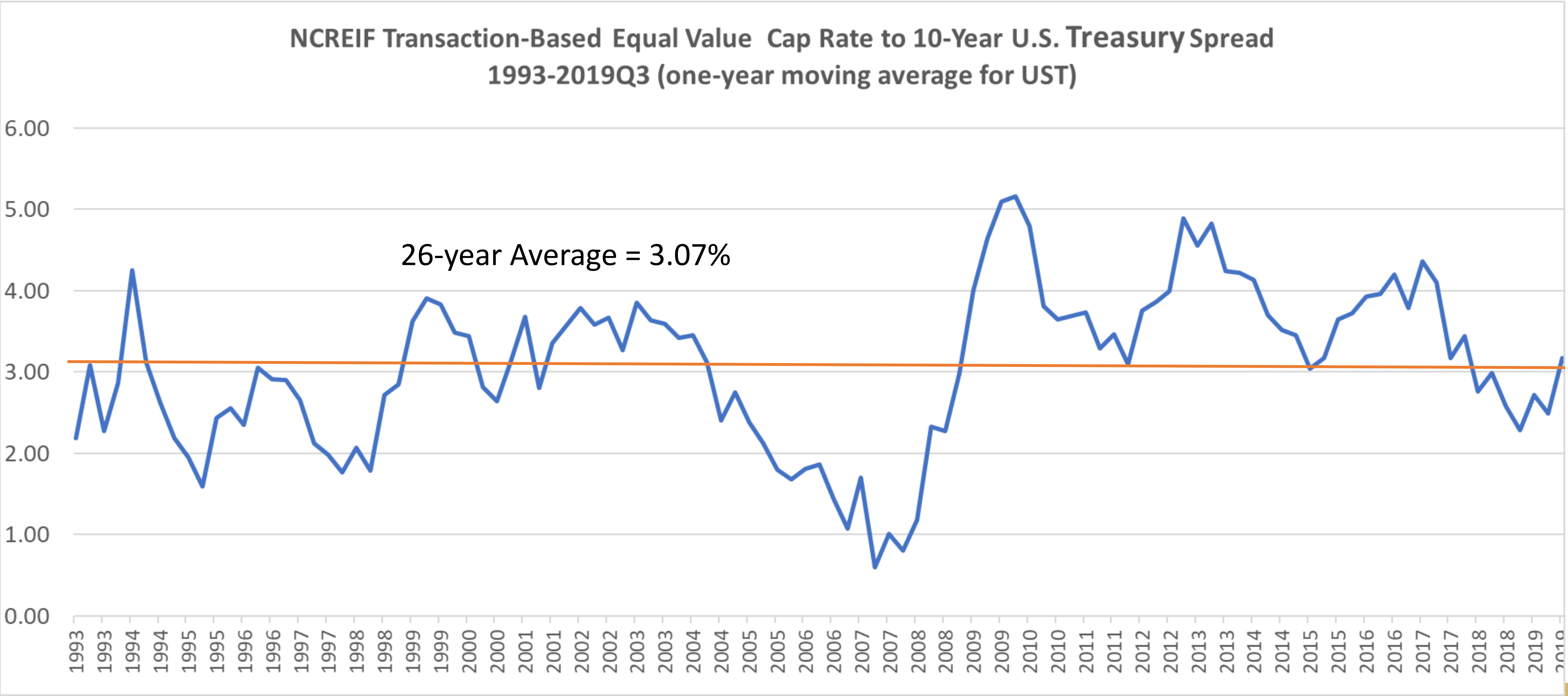
. . . . property returns across property type are similar, in the longer-run office underperforms . . . .

National Property Index Returns By Property Type (through 2019Q2)

	1 Year	5 Year	10 Year	20 Year
National Property Index	6.5%	8.8%	9.3%	8.9%
Apartments	5.8%	8.0%	9.4%	8.7%
Industrial	13.9%	13.7%	11.4%	10.0%
Office	6.8%	8.2%	8.4%	8.2%
Retail	1.8%	7.7%	9.2%	9.9%

Source: NCREIF Real Estate Performance Report, 2019Q2. and Graaskamp Center for Real Estate.

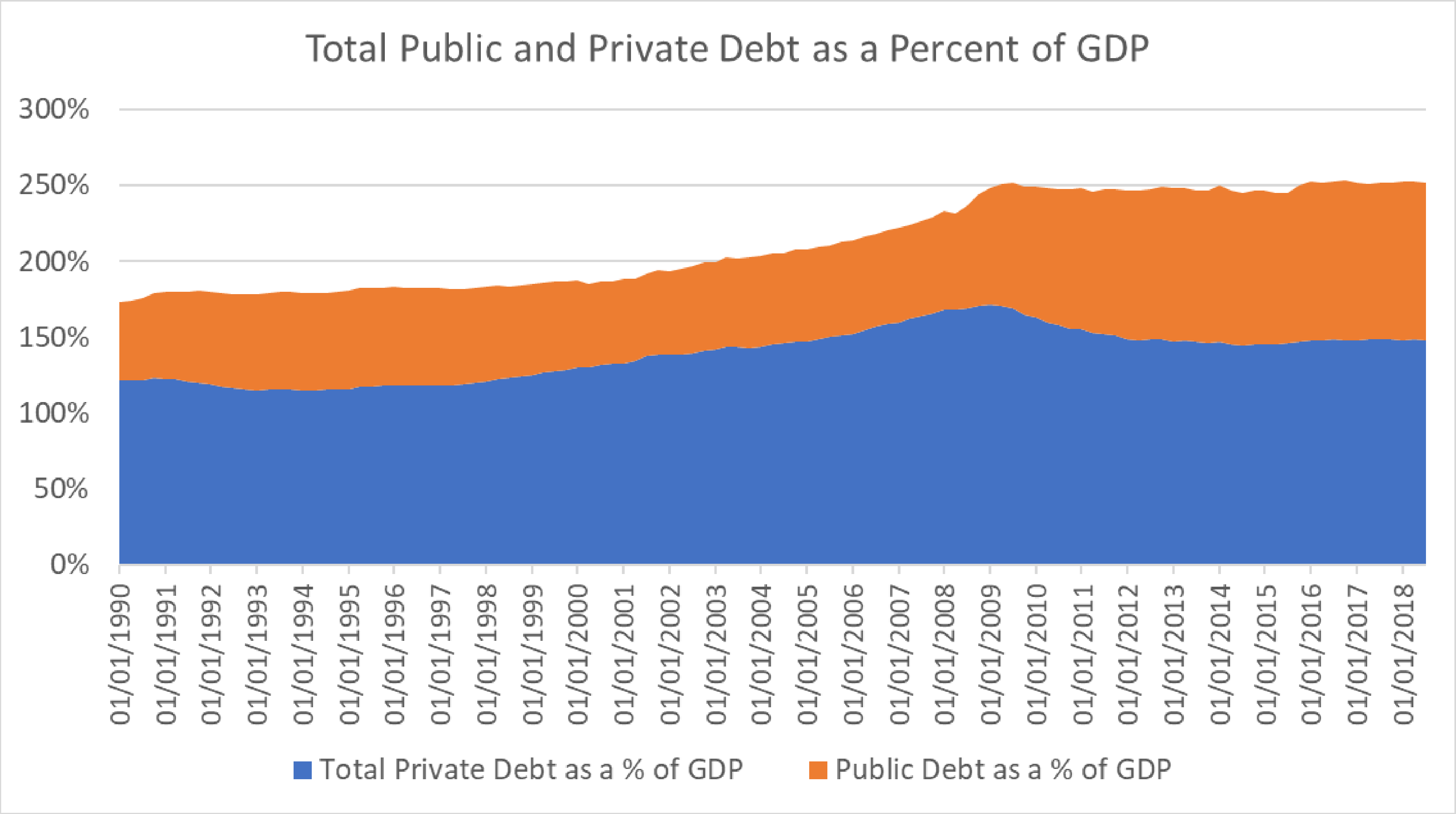
. . . . cap rate risk spreads to 10-year Treasuries are range-bound.



Sources: Federal Reserve Economic Data, NCREIF, and Graaskamp Center for Real Estate

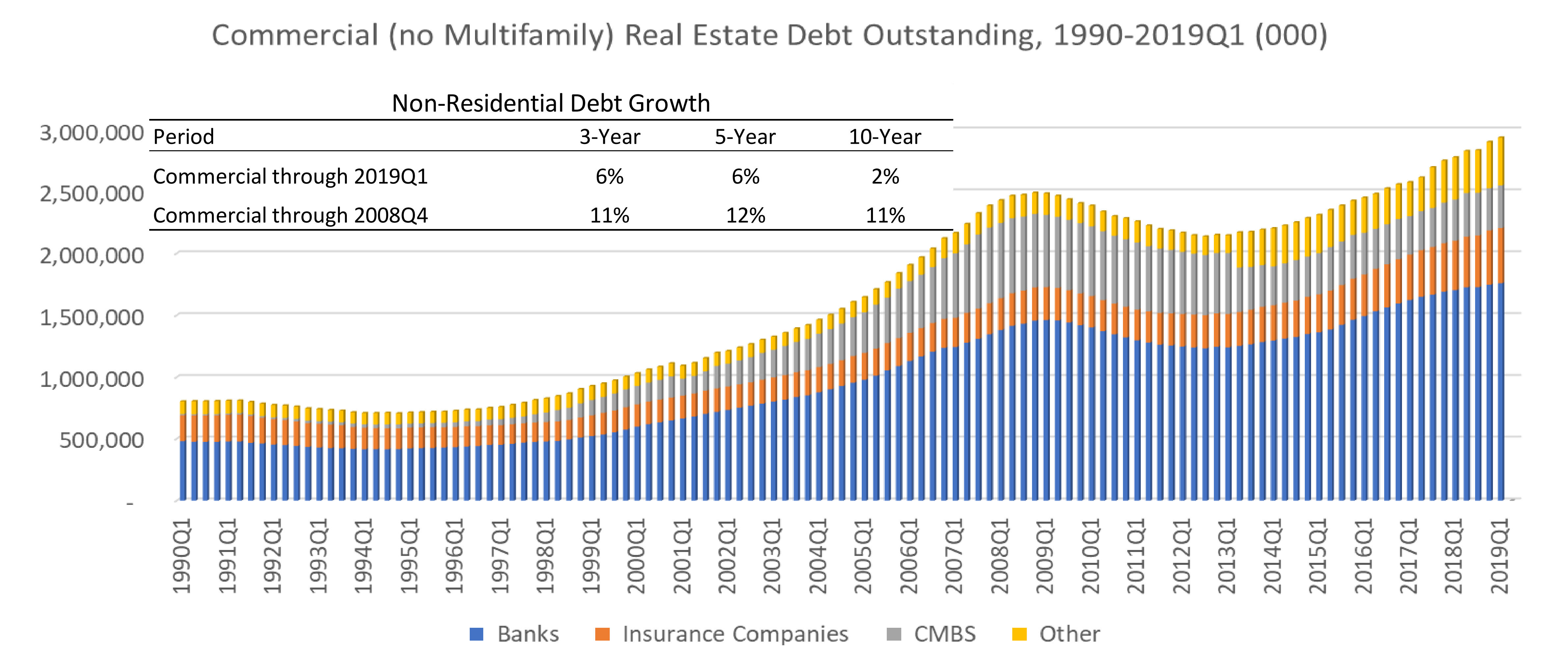
Real Estate Debt Capital Markets

Private debt as a percent of GDP has fallen from 171% in 2009 to 148% today . . . .



Source: Federal Reserve Economic Data and the Graaskamp Center.

. . . . commercial real estate debt outstanding has grown over the last several years . . . .

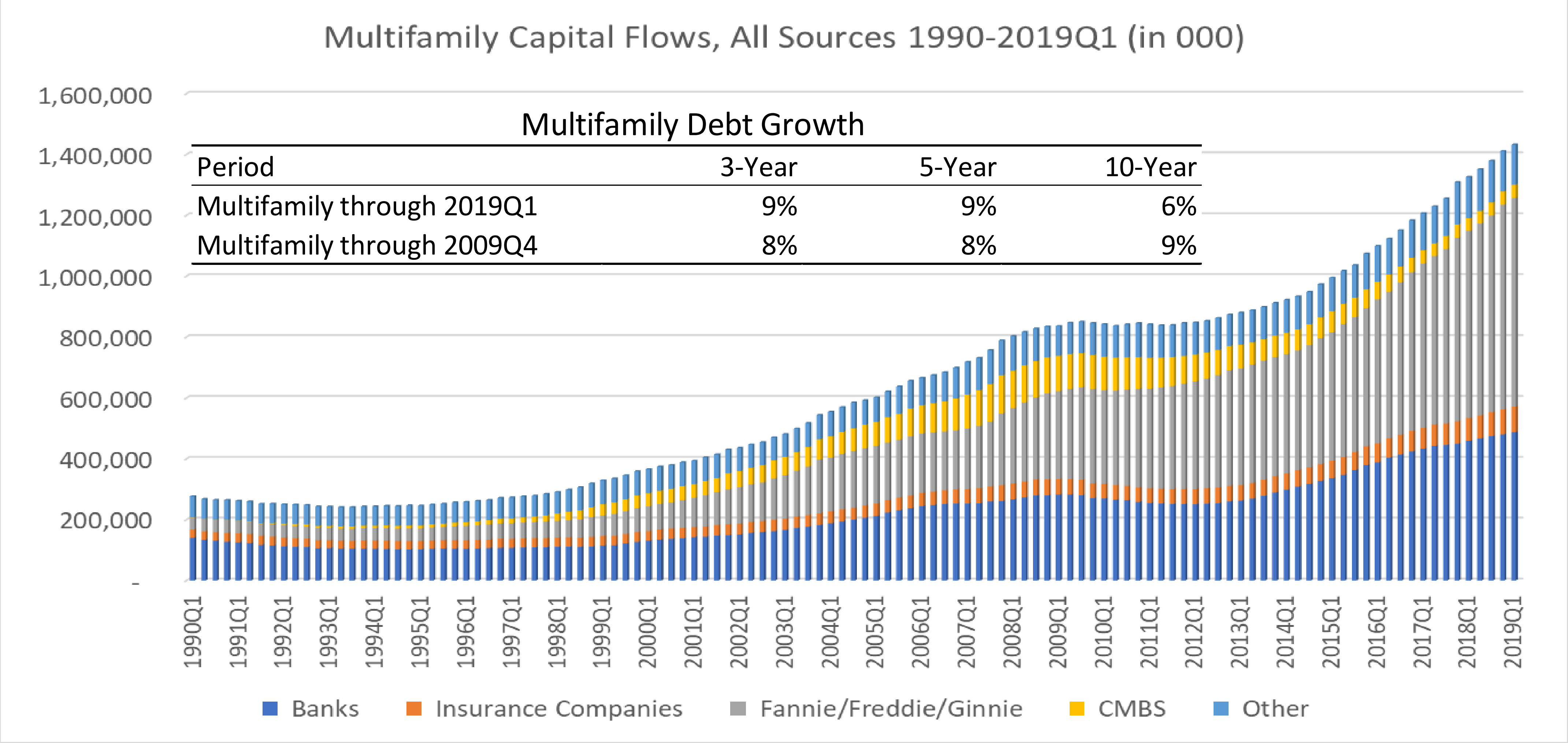


Non-Residential Debt Growth

Period	3-Year	5-Year	10-Year
Commercial through 2019Q1	6%	6%	2%
Commercial through 2008Q4	11%	12%	11%

Source: Federal Reserve Flow of Funds and the Graaskamp Center

. . . .multifamily debt is growing at an unsustainable pace (maybe) . . . .



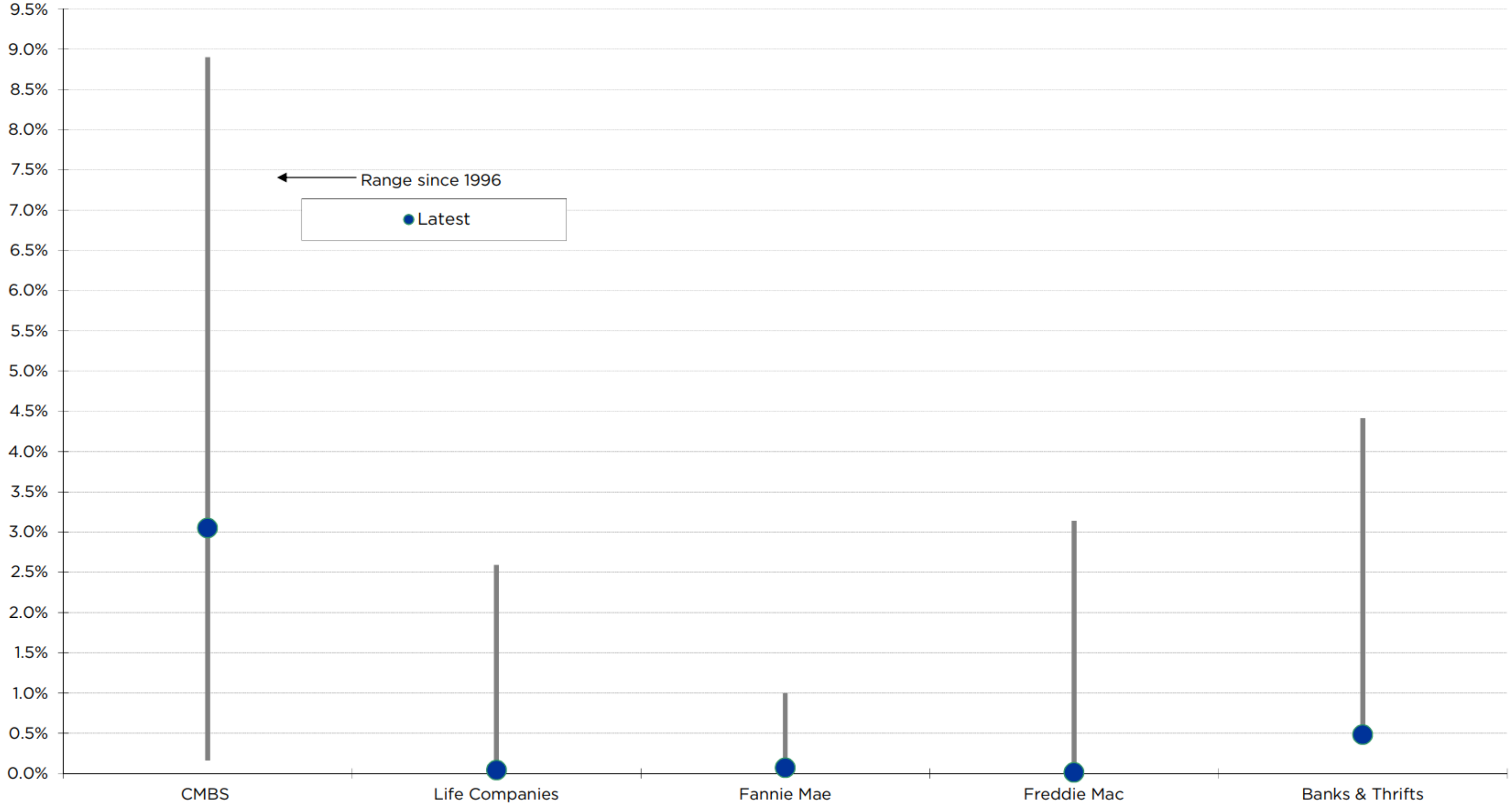
Multifamily Debt Growth

Period	3-Year	5-Year	10-Year
Multifamily through 2019Q1	9%	9%	6%
Multifamily through 2009Q4	8%	8%	9%

Source: Federal Reserve Flow of Funds and the Graaskamp Center.

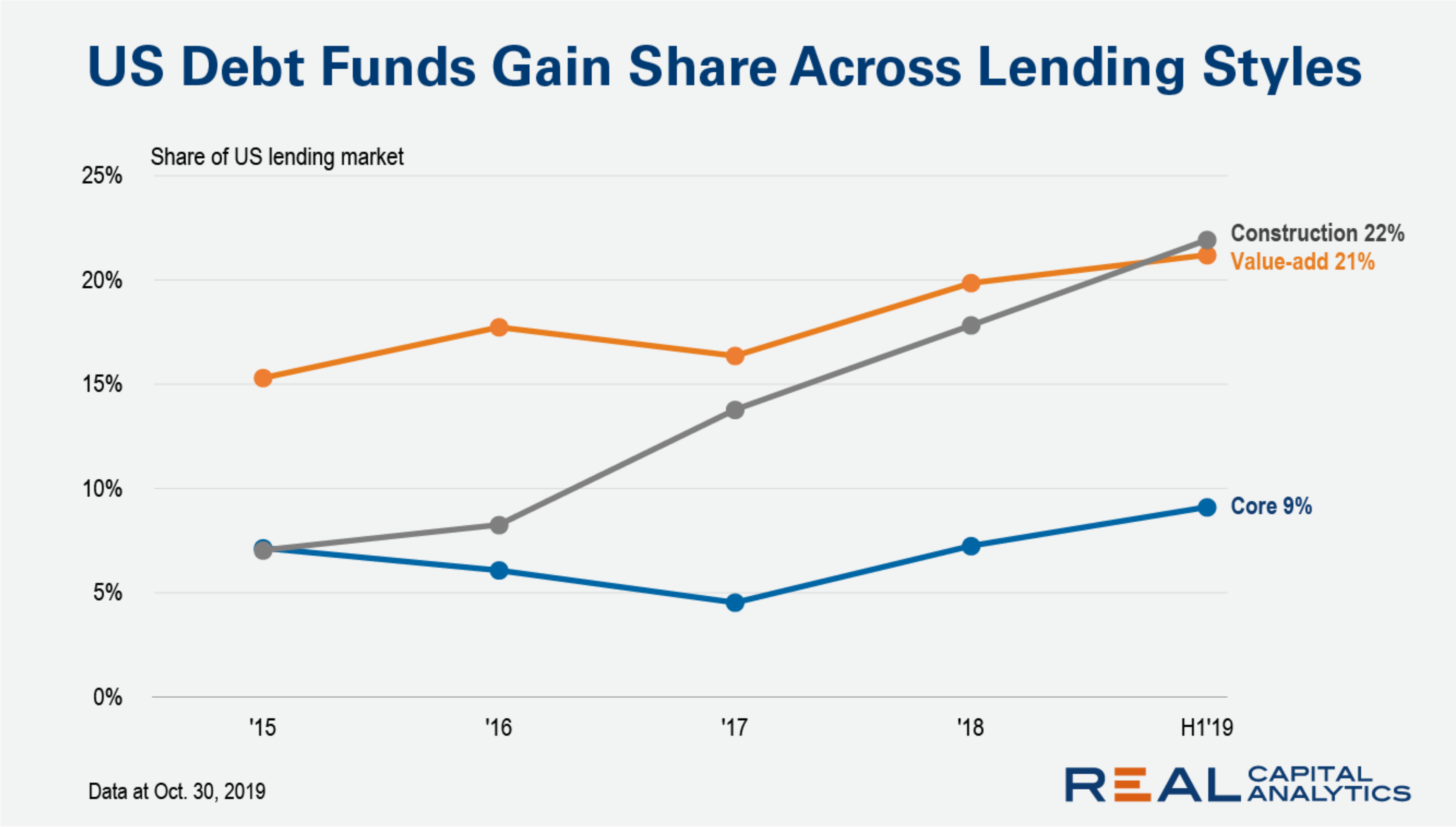
. . . . delinquency rates are at or near 20-year lows for all but CMBS . . . .

Delinquency Rate Range 1996-2018 for Select Real Estate Lenders



Source: Mortgage Bankers Association, Commercial/Multifamily Databook 2018Q3.

. . . . leveraged loan lenders are pushing traditional real estate lenders . . . .



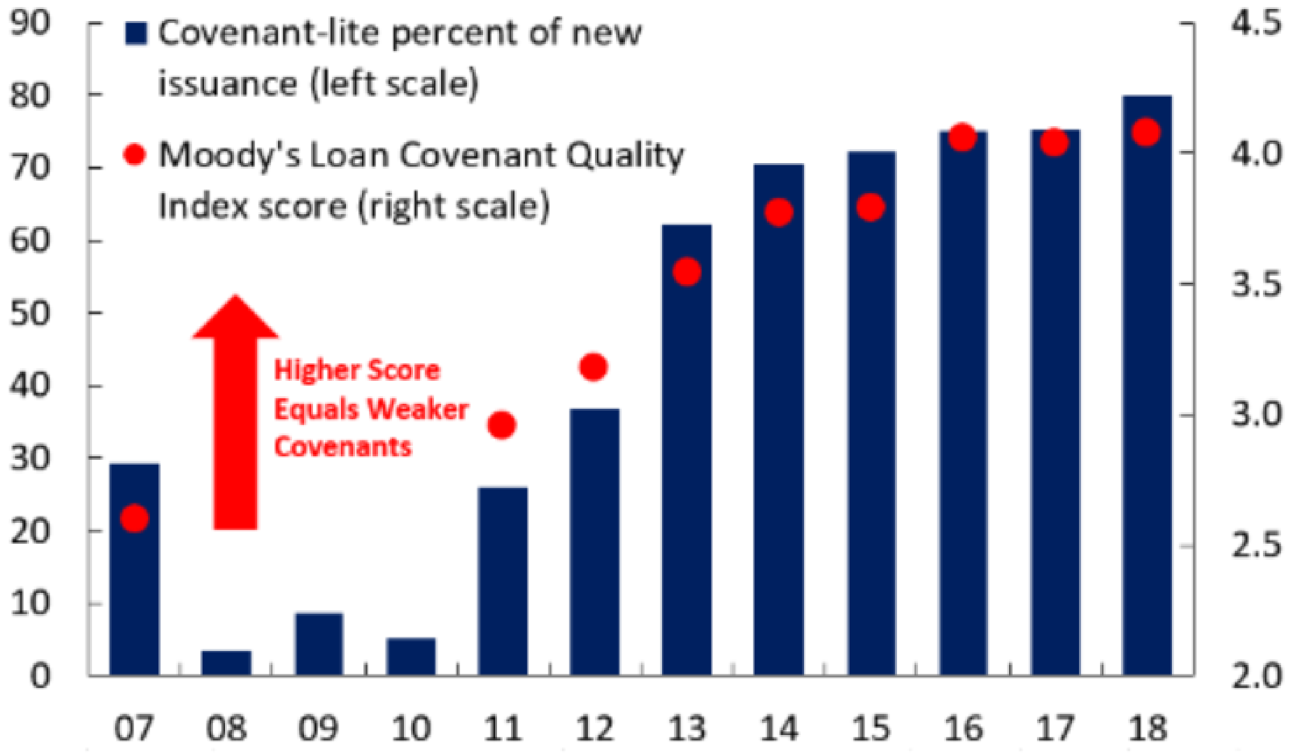
Source: Jim Costello, Real Capital Analytics, U.S. Debt Funds Carve a Bigger Slice of Lending, October 30, 2019

. . . . late cycle, covenant lite, corporate lending is the norm in leveraged loan underwriting . . .

Less investor protection

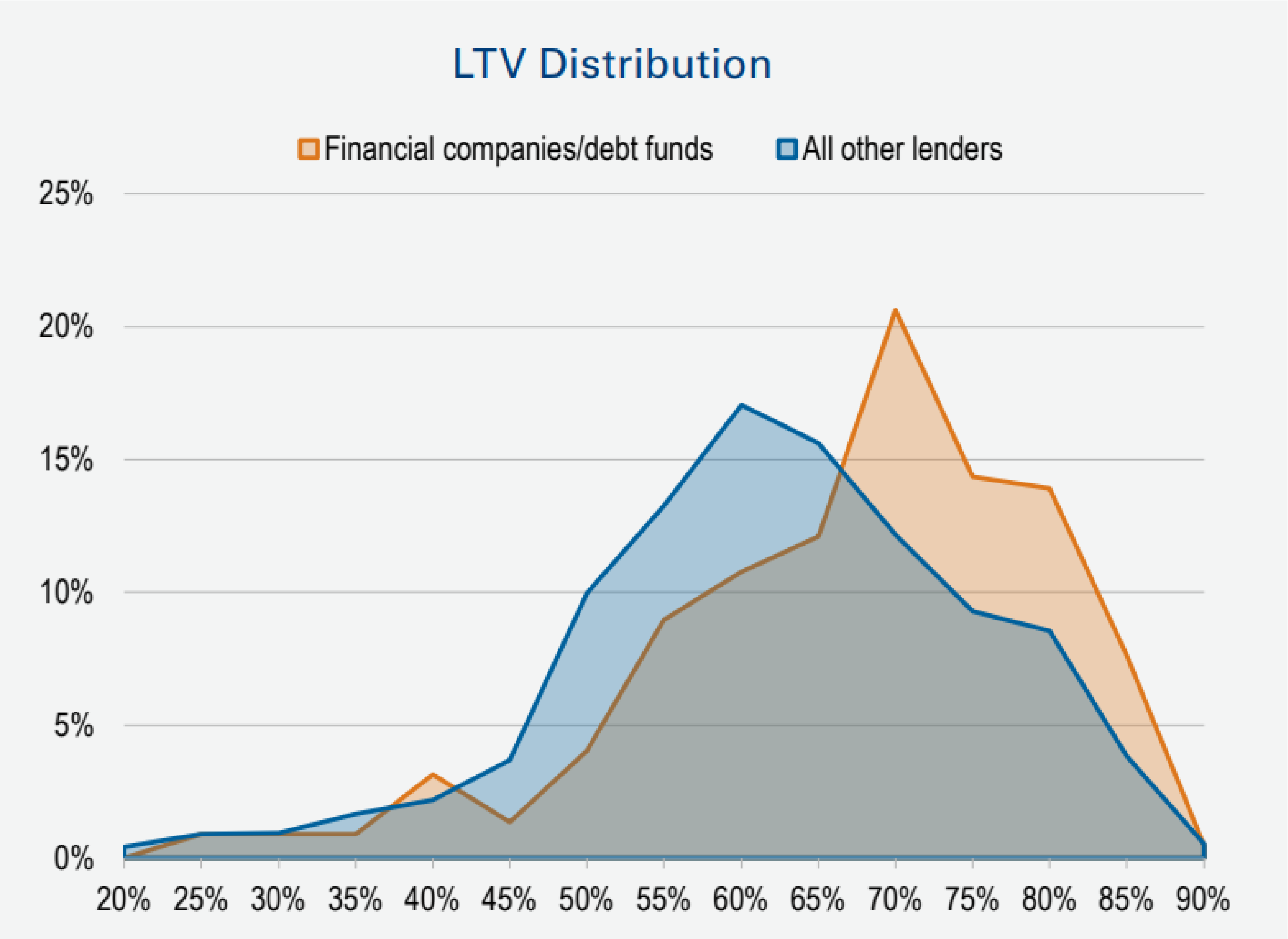
The volume of loans with fewer investor protections, known as covenants, has grown in the United States, and quality has weakened.

(percent of issuance)



Source: IMFBlog, Sounding the Alarm of Leveraged Lending
Tobias Adrian, Fabio Natalucci, and Thomas Piontek, November 15, 2018

. . . . real estate debt funds are pushing bank debt underwriting.



Source: Jim Costello, Real Capital Analytics, U.S. Debt Funds Carve a Bigger Slice of Lending, October 30, 2019

Real Estate Equity and Debt Markets

There is an abundance of equity capital and it will remain abundant

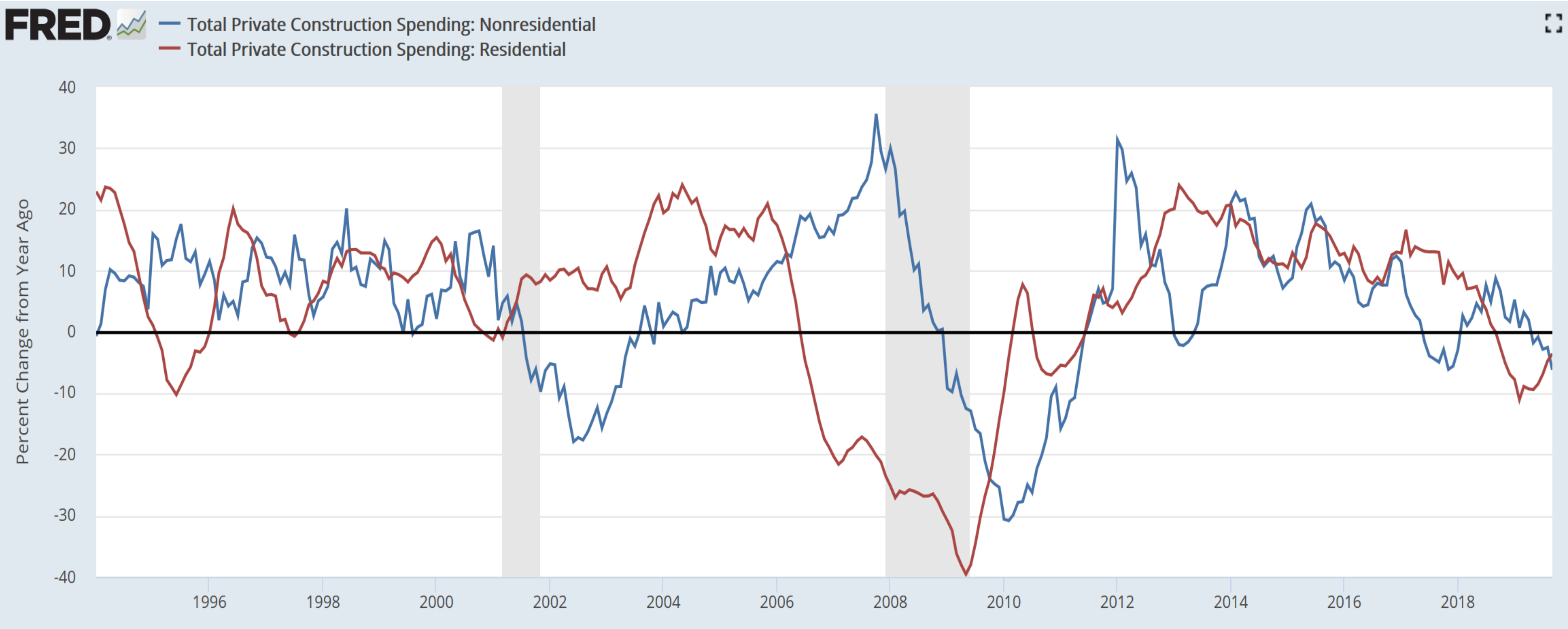
Equity investment is maintaining discipline at current cap rates

The debt markets are awash in capital, but will start to push risk covenants

Leveraged loan funds pushing traditional bank lender underwriting standards, leveraged loan volume will tighten

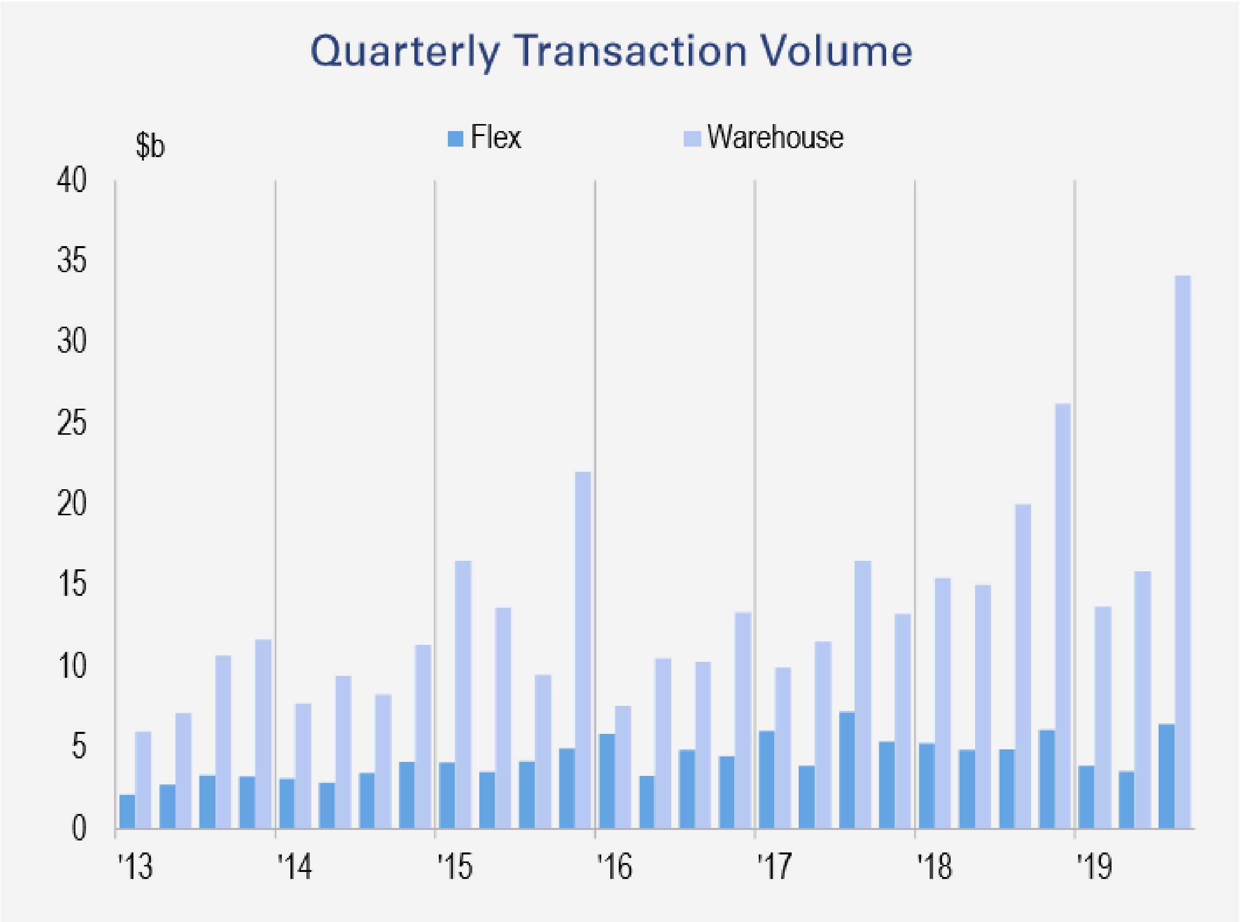
The Property Markets

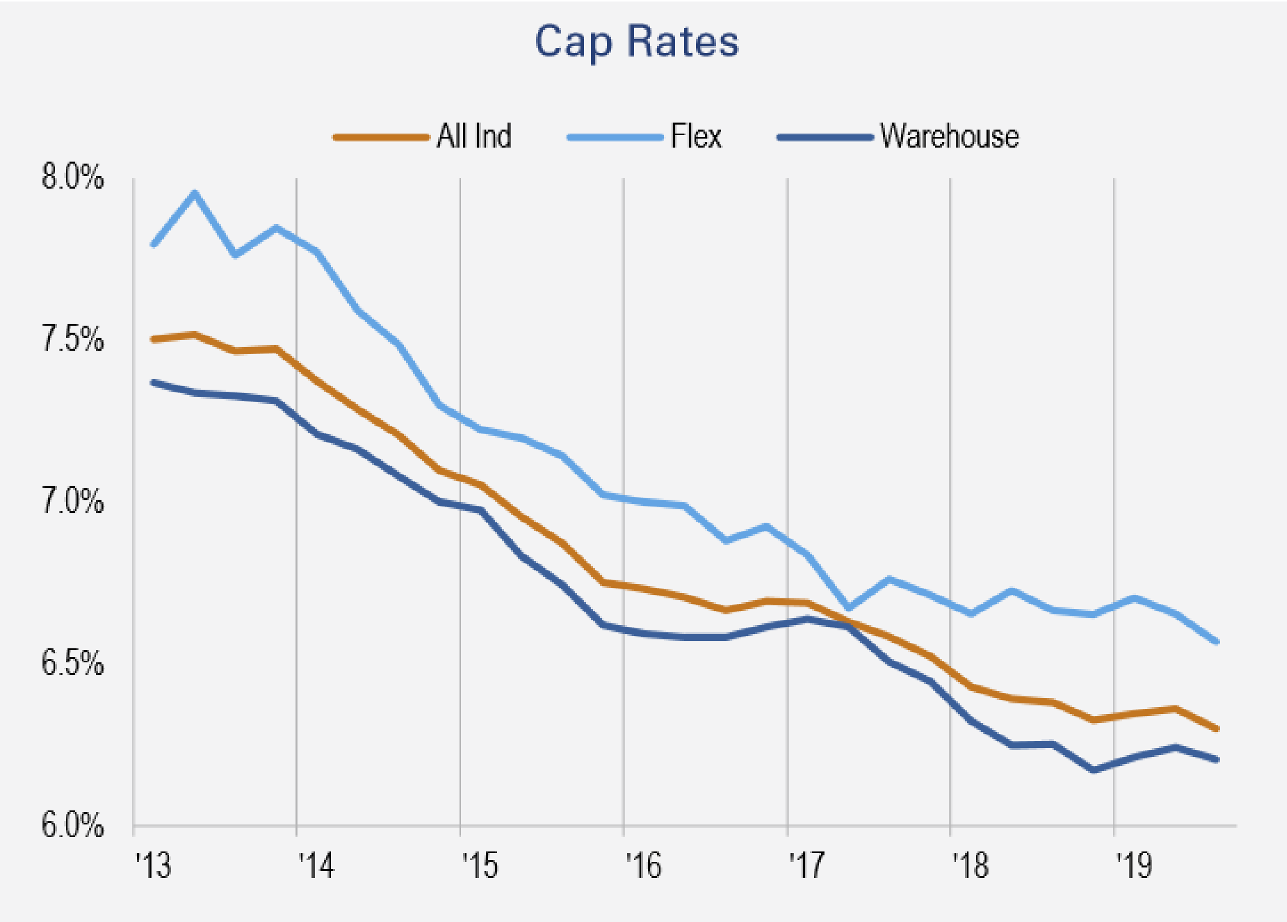
Residential and non-residential construction is shrinking . . . . supply is getting in check . . . .



Source: Economist, "Corporate America's Confidence and Profits are Sagging," October 23, 2019

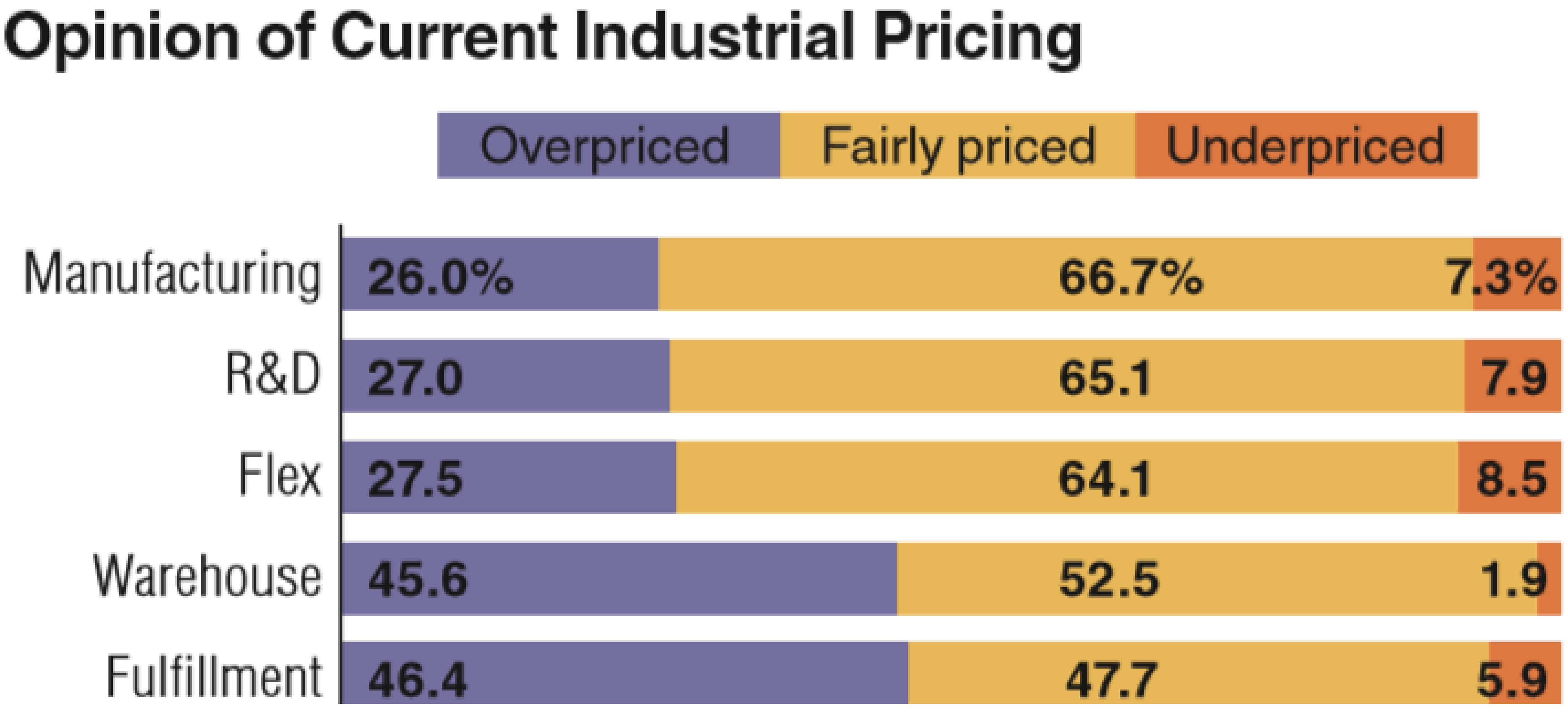
. . . . industrial trends, transaction volume is up 63% YOY . . . .





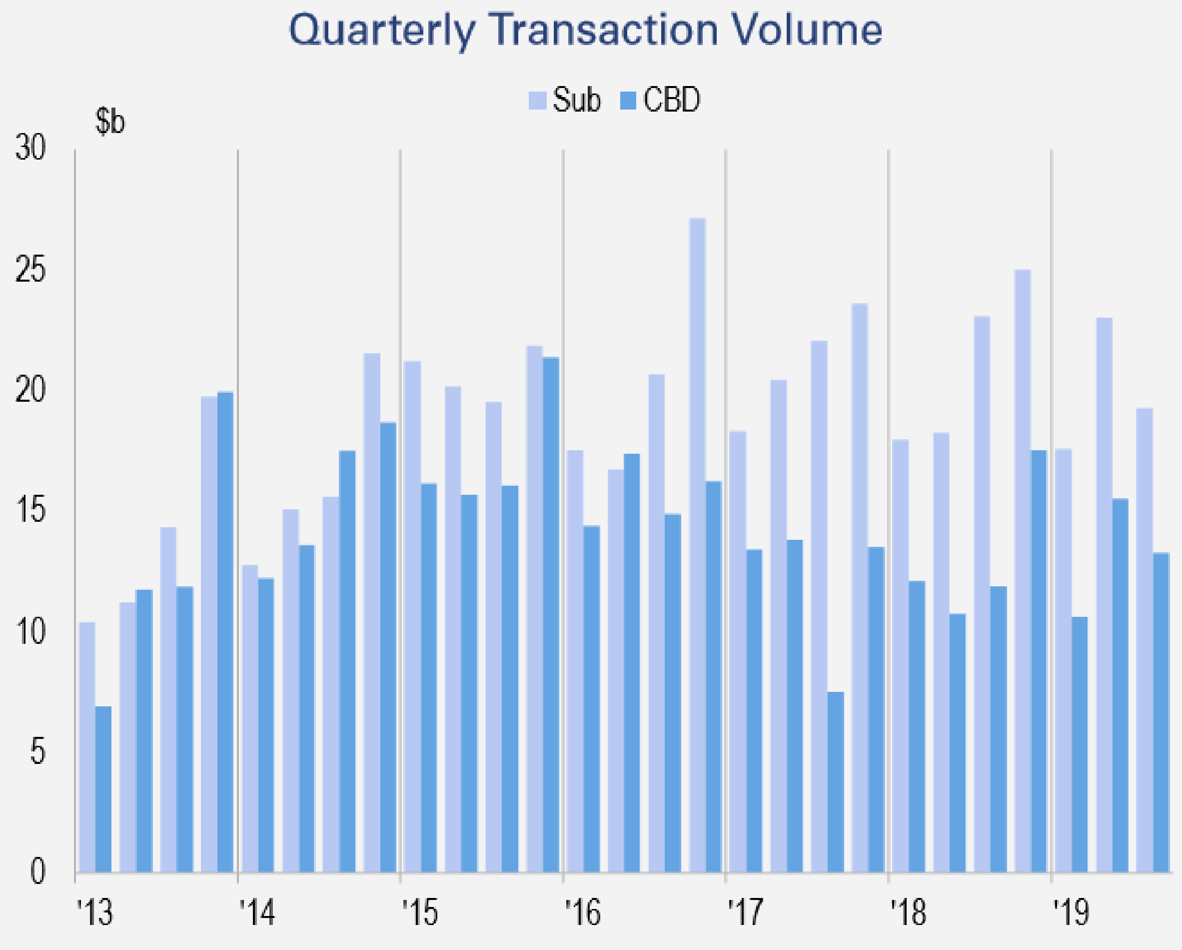
Source: Retal Capital Analytics, U.S. Capital Trends: Industrial, 2019Q3.

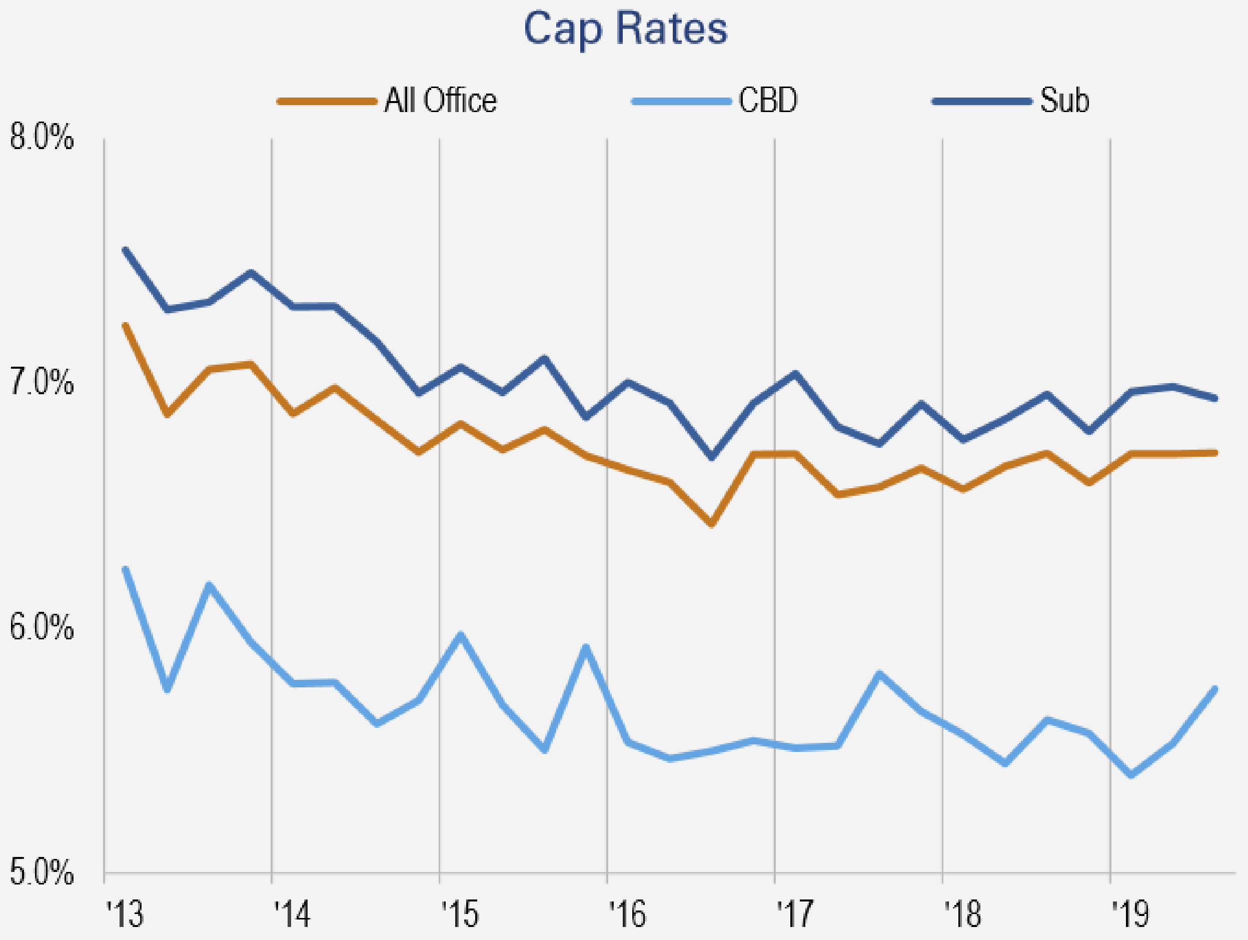
. . . . industrial pricing perceptions . . . .



Source: ULI, *Emerging Trends in Real Estate 2020,* survey.

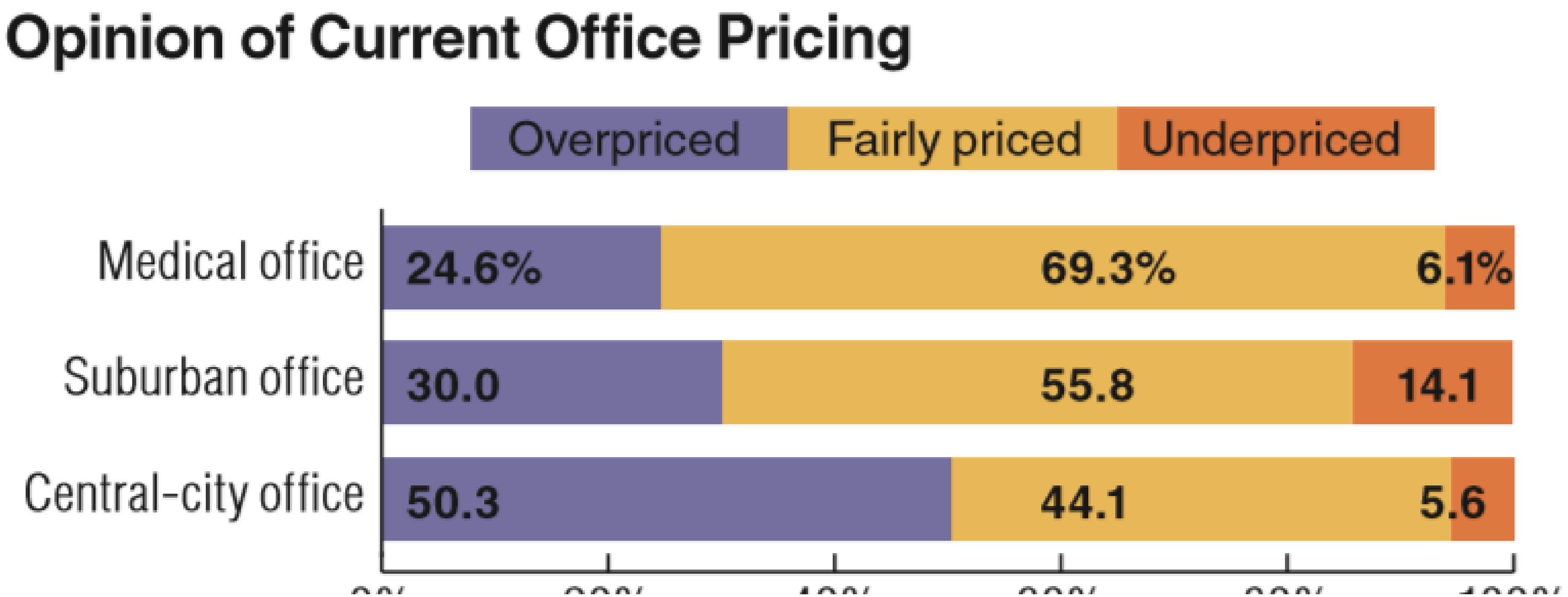
. . . . office trends, transaction volume is off 7% YOY. . . .





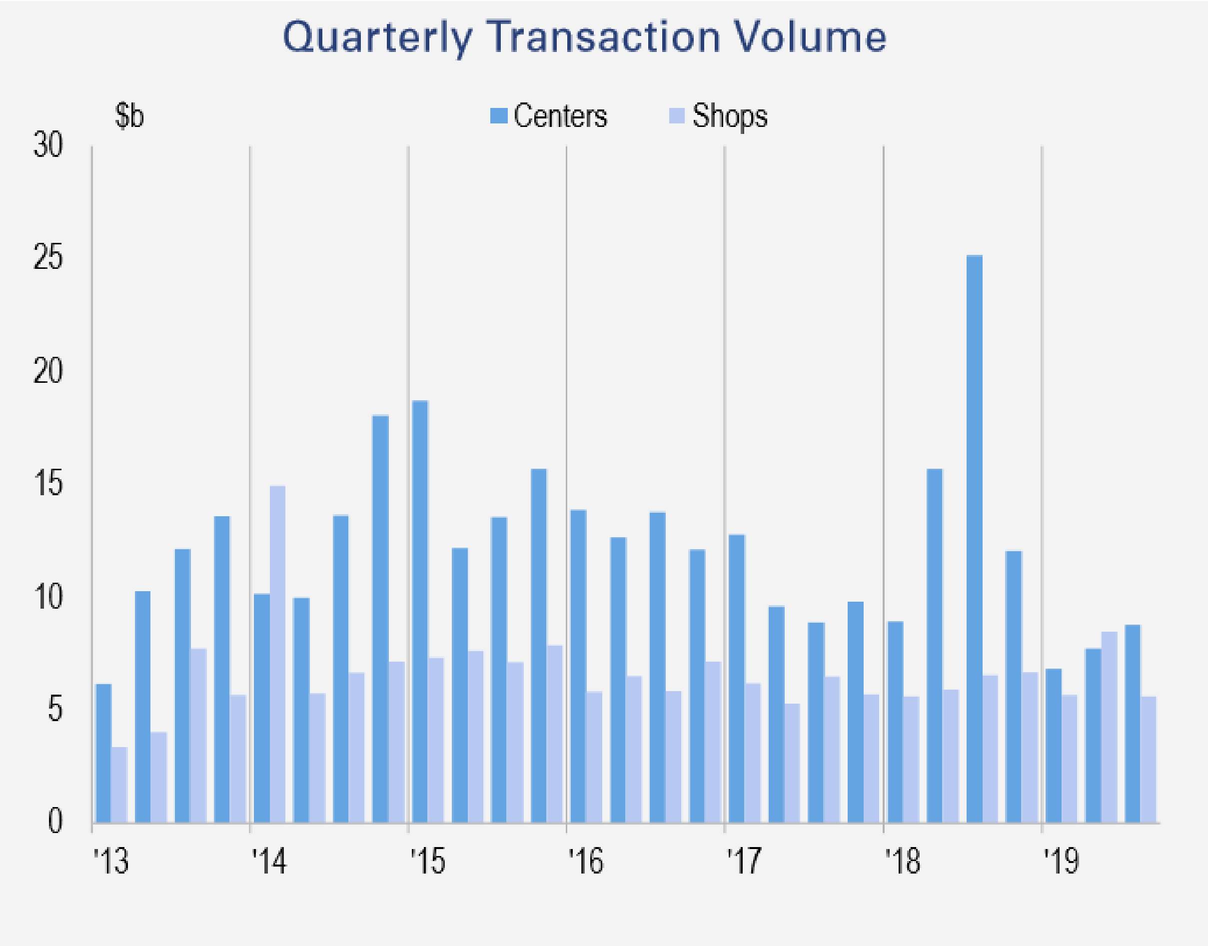
Source: Retal Capital Analytics, U.S. Capital Trends: Office, 2019Q3.

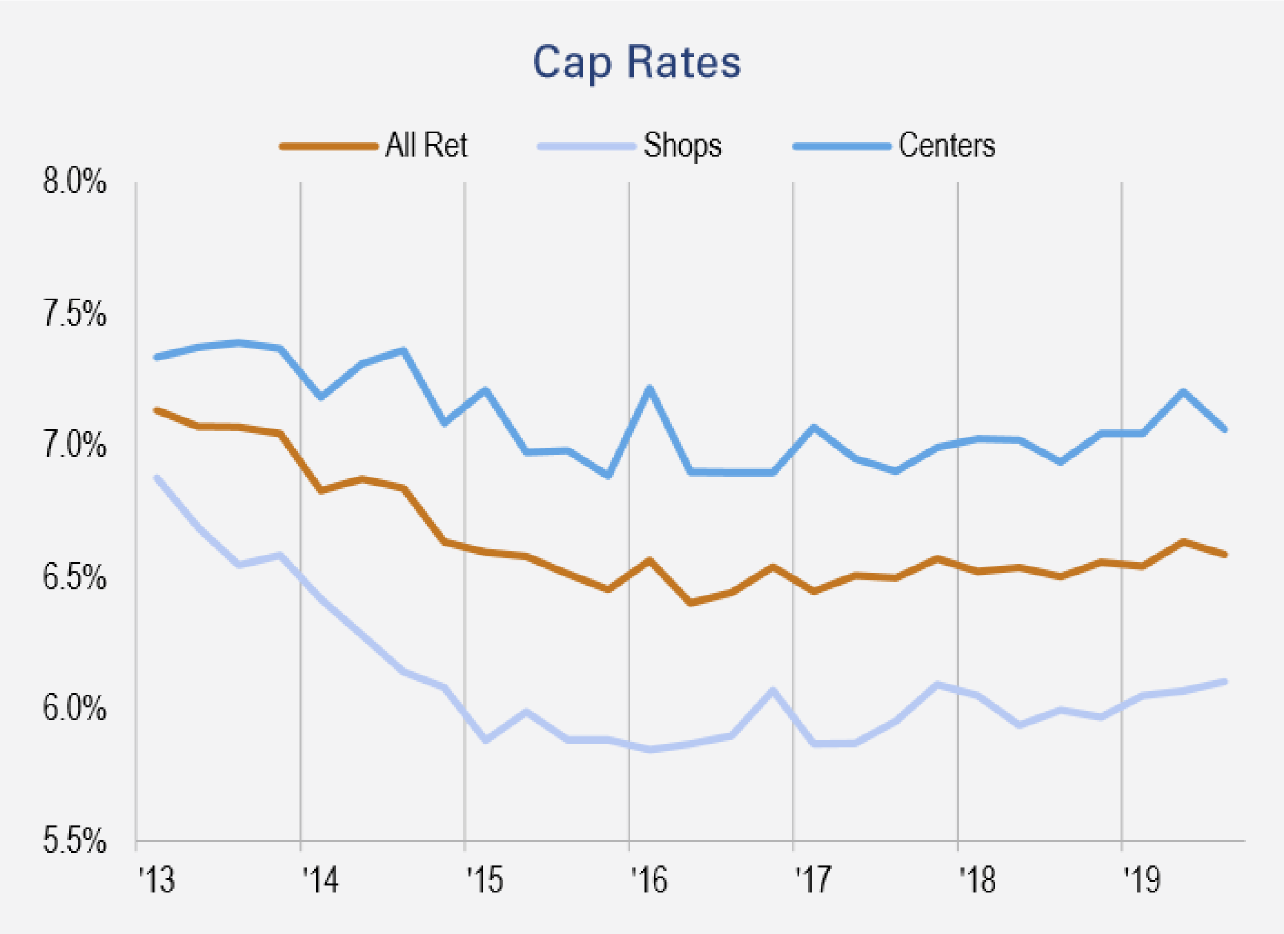
. . . . office pricing perceptions. . . .



Source: ULI, *Emerging Trends in Real Estate 2020,* survey.

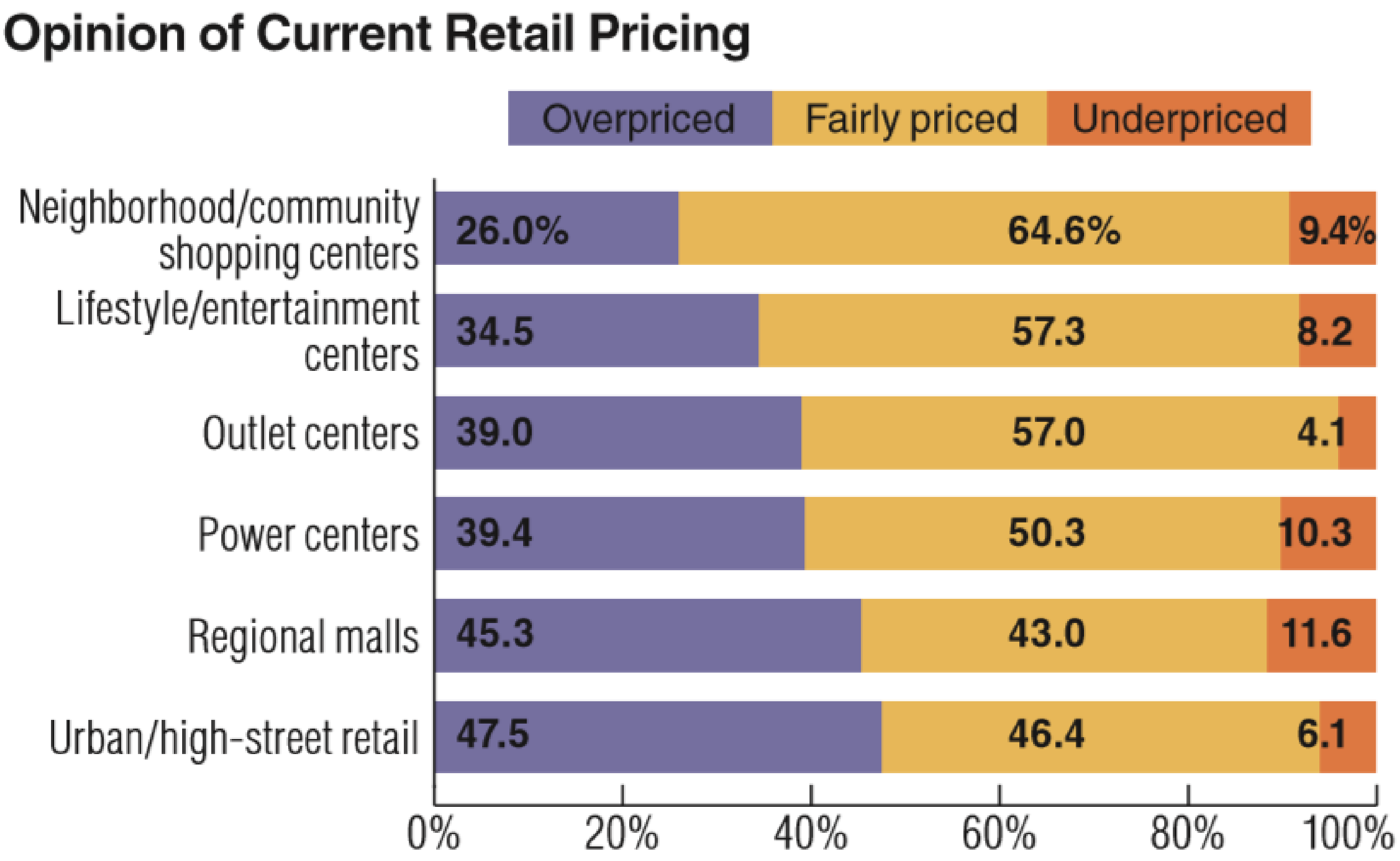
. . . . retail trends, transaction volume has plummeted 55% YOY . . . .





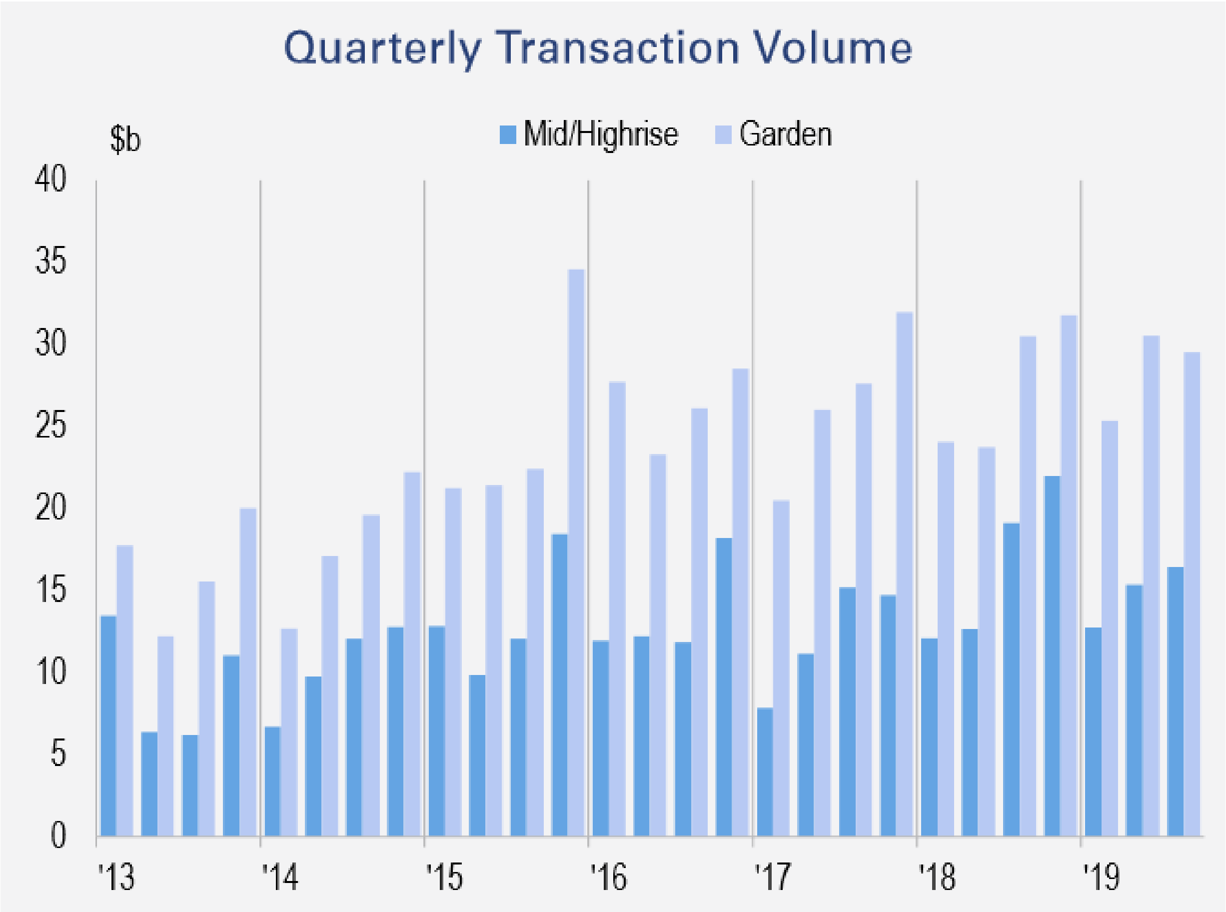
Source: Retal Capital Analytics, U.S. Capital Trends: Retail, 2019Q3.

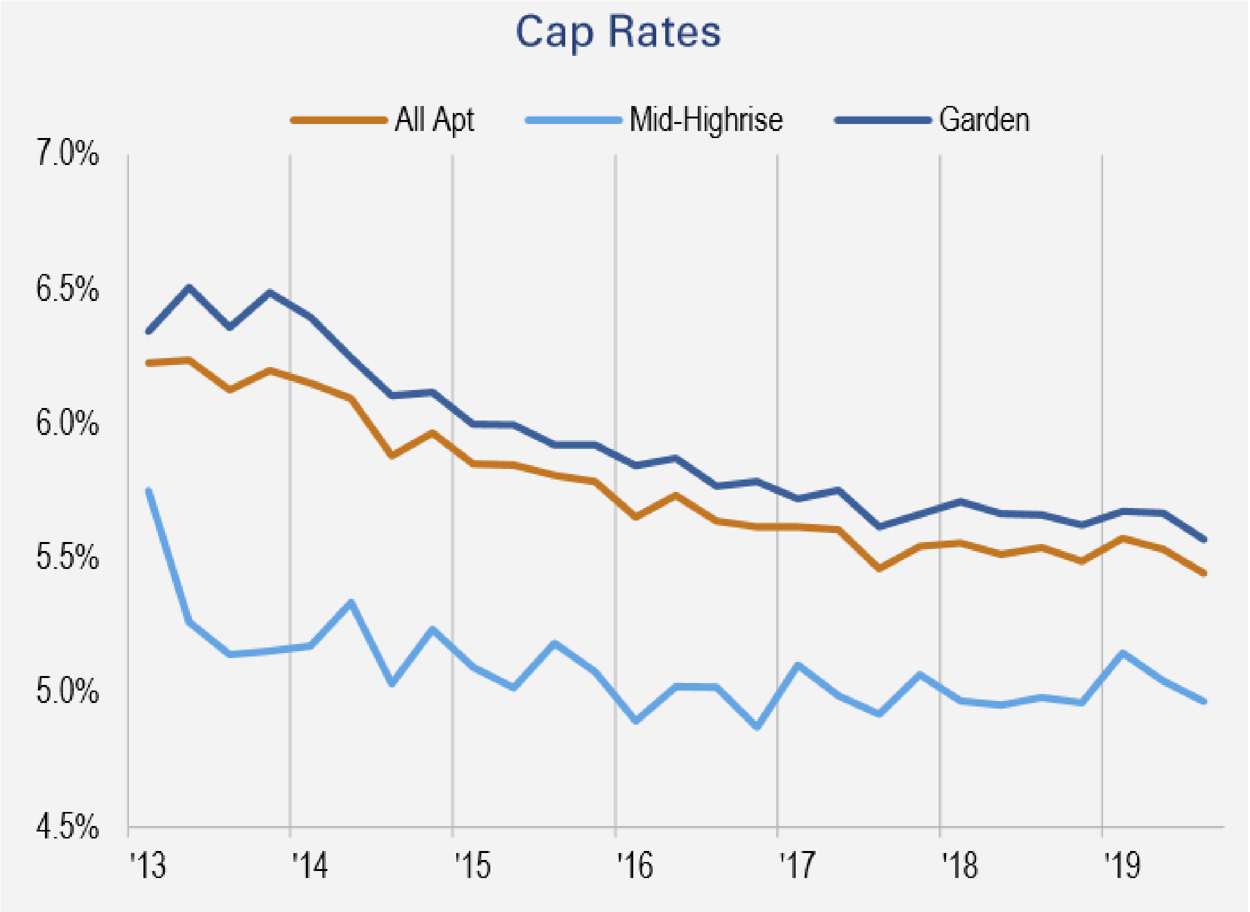
. . . . retail pricing perceptions. . . .



Source: ULI, *Emerging Trends in Real Estate 2020,* survey.

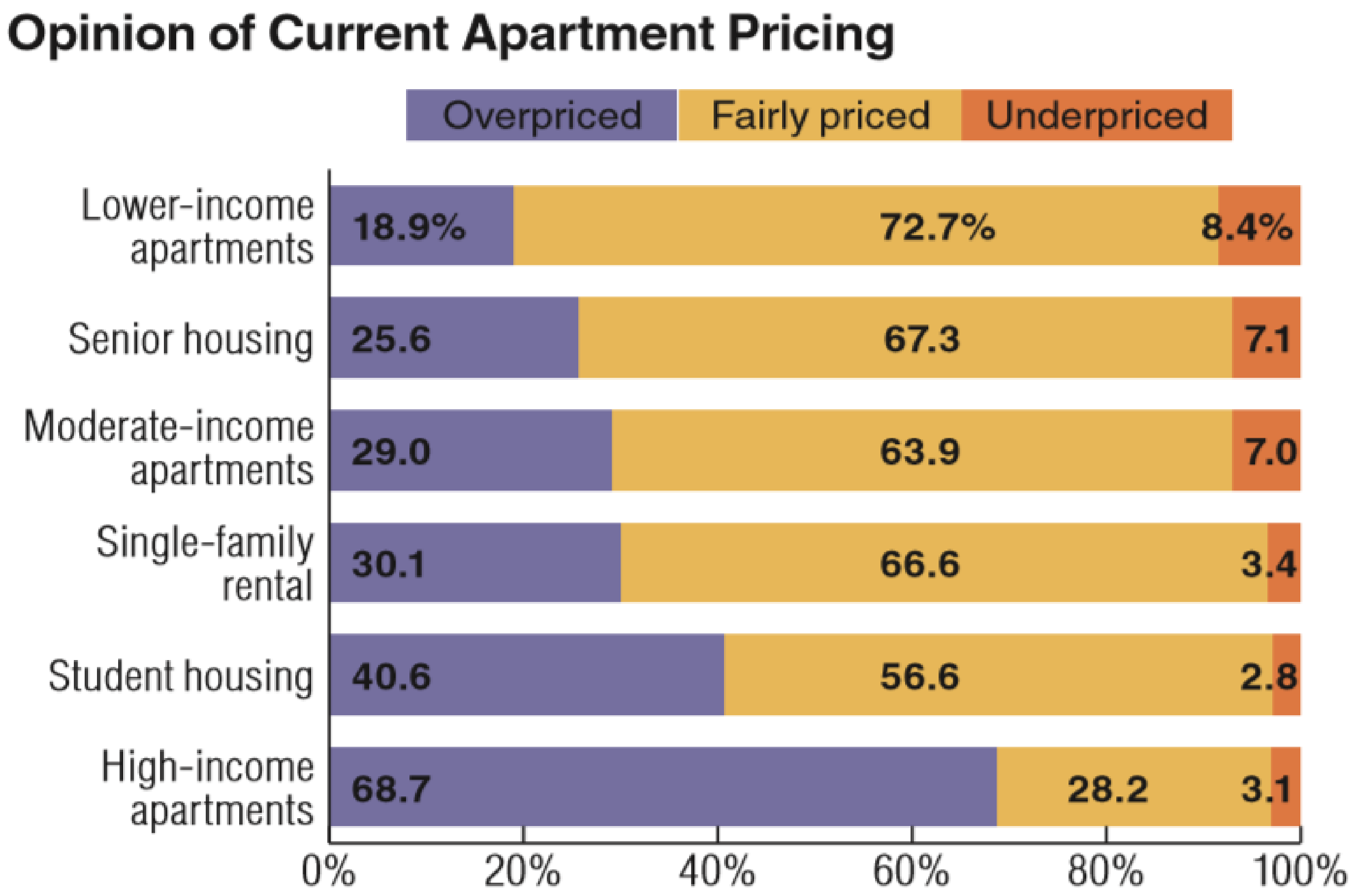
. . . . apartment trends, transaction volume is off 7% YOY. . . .





Source: Retal Capital Analytics, U.S. Capital Trends: Apartments, 2019Q3.

. . . . apartment pricing perceptions, We are building 90 percent of our housing for 10 percent of our households." . . . .



Source: ULI, *Emerging Trends in Real Estate 2020,* survey.

The Forecast: 2020 "Perfect Vision?"

Asset prices:

- Cap rates will widen out by 25 bp to account for new risk premiums

Equity capital:

- Transaction volumes will fall by 5% over economic and pricing concerns

Debt capital markets:

- Will begin to tighten as the Fed clamps down on leveraged loan banks

Space markets:

- Apartment overbuilding and weaker absorption will reduce YOY NOI
- Business uncertainty will reduce warehouse demand – watch your spec space

GDP growth:

- 2.0% YOY and falling to 1.0%

Wage inflation concerns will keep interest rates from falling, weak economy as an offset

- 10-year UST at about 1.80-2.00% this time next year

2020 REAL ESTATE FORECAST: LOCAL OUTLOOK

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Q&A

2020 Real Estate Forecast

Urban Land Institute Chicago