THE 2024 CHICAGO MID-YEAR SENTIMENT REPORT

DEPAUL UNIVERSITY IN PARTNERSHIP WITH URBAN LAND INSTITUTE CHICAGO DISTRICT COUNCIL

THE RESULTS ARE IN

Chicago, like most major markets across the U.S., is deeply entrenched in "The Great Reset." Originally launched in the aftermath of the pandemic, today the reset has become increasingly more challenging. The elimination of the zero-interest rate policy (and the rapid escalation of interest rates), stubborn but steadily declining inflation, and the struggle of most asset classes to find a valuation floor all are contributing factors.

Results from the 2024 Chicago Mid-Year Sentiment Survey, a joint initiative of The Real Estate Center at DePaul University and Urban Land Institute, Chicago District Council, and a series of interviews with commercial real estate experts proved fascinating. Some in the industry voiced concern and question whether we've hit bottom or are still at risk of catching the proverbial falling knife. Other cycle-tested veterans wholeheartedly believe that one owner/investor's distress is another's opportunity.

Among the most intriguing findings of the survey include:

- The bulls and bears are both in town, it all depends on where you look! According to the survey, 56% of real estate professionals are bearish or concerned about the state of the market for the balance of 2024. From a wider lens—24 to 36 months—the bulls take over, with 60% expressing bullishness and optimism.
- Chicago real estate professionals are more confident that a recession will be avoided than they were mid-year 2023.
- More than half of professionals expect that the Fed's efforts will produce a soft landing; the number expecting a hard landing has been halved from one year ago to 18%.
- Fewer people believe the bid-ask spread will widen in 2024; of those who believe the spread will narrow, 62% believe it will be the result of seller capitulation.
- Safety and taxes in general, especially property taxes, are among the greatest short and long-term concerns about investing in and doing business in Chicago.
- The three most concerning market risks are inflation, rising interest rates, and the potential for a recession.

According to Reagan Pratt, the Douglas and Cynthia Crocker Endowed Director of the Real Estate Center at DePaul University, the general optimism expressed by investors and developers who are active and opportunistic participants in “The Great Reset” is not surprising.

“The innate optimism we are seeing, in spite of challenging market conditions, reinforces the resilience and long-range view of many real estate investors and developers,” Pratt said. “The long-lived nature of the asset class and the locational immobility means investors need a vision for and confidence in the future of the market.”

“In Chicago and in markets across the country we are facing complex times. At times that are characterized as turning points in the market (often only recognized as such in hindsight) a belief in a better time is natural,” he concluded.

Finally, heated political discourse, both locally and nationally, that is all too often dogmatic and not looking for solutions, is a common concern that was expressed in interviews and written responses to the survey. Perhaps if everyone compromises a little bit here and a little more there, we can accomplish a narrowing of this big spread, just as a majority expect the pricing gap to narrow.

PLAYING WITH THE BULLS & BEARS

In the 2024 survey, commercial real estate professionals were significantly more bullish about the prospects for the balance of the year than they were a year ago, but optimism was not a majority opinion. Forty four percent of participants characterized themselves as either bullish or trending toward optimistic. Yet more than one third, 34%, characterized themselves as bearish.

At this time one year ago, 17.9% were bullish or optimistic, and 45.7% were bearish.

When taking the long view, CRE professionals flipped their perspectives from one year ago. At mid-year 2024, 60% are either bullish or optimistic about the next 24-26 months. One year ago only 39.1% had that view.

Whether you run with the bulls or hibernate with the bears in part depends on your role within the commercial real estate industry and your current portfolio composition.

The following is a sampling of written comments from the survey, offered anonymously.

- "The depth of the Chicago market cannot be denied. Despite capital turning away from Chicago, the relative demand and size of the market remain."
- "The political climate makes it hard to be bullish…"
- "The financial wherewithal of Chicago/Illinois continues to be an issue."
- "Transaction volume is increasing; price discovery has matured to where there is more acceptance in the marketplace. But it still will take time to work through this to see any value appreciation."
- "The lack of institutional investor interest in even our best performing asset class, multifamily, is worrisome."
- "Taxes are killing investment properties. Many investors will not touch Cook County. "

A MIXED ECOMOMIC BAG: THE BID-ASK SPREAD, INFLATION & RECESSION

Chicago, like much of the rest of the country, continues to be in reset mode, as capital market activity in Chicago was down significantly from 2023 to 2022, and hasn't improved dramatically for the first half of 2024. Accordingly, valuations of virtually all property types have declined substantially.

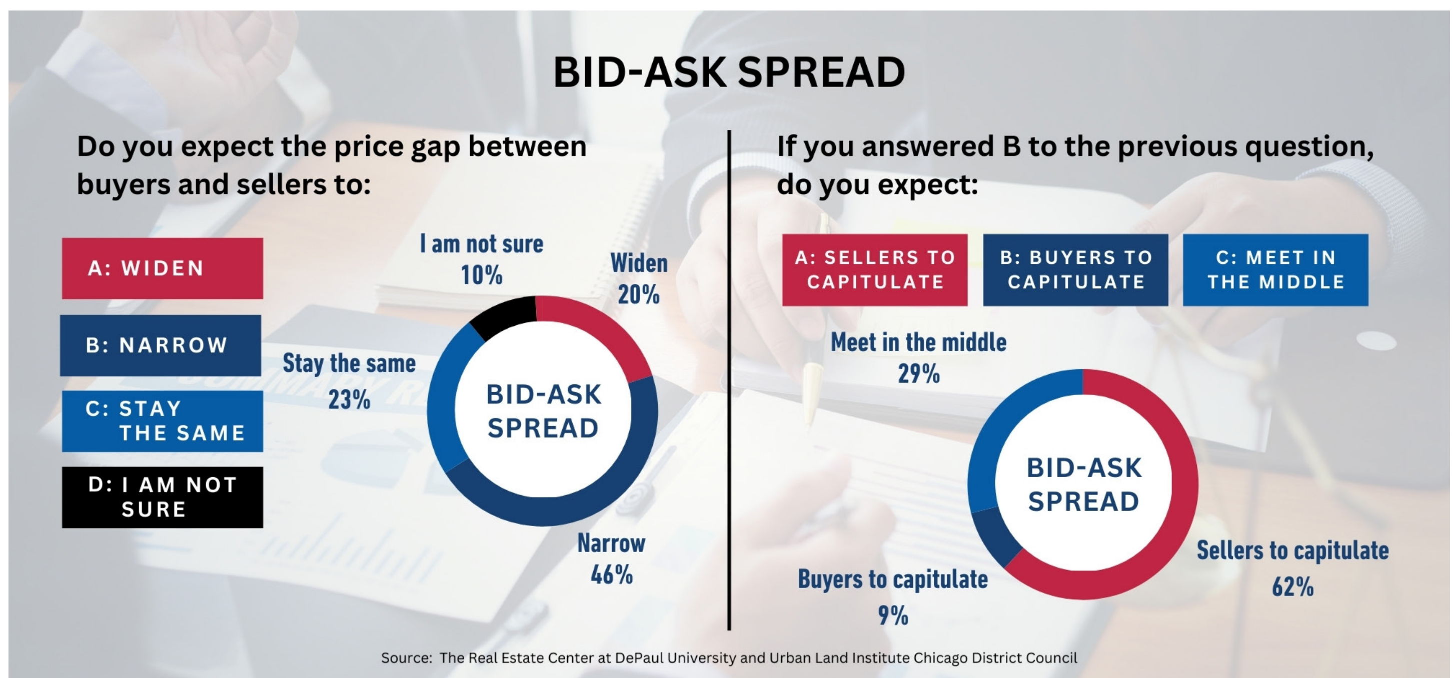
Interest Rates

While there appears to be good news on the horizon, starting in September, the market has suffered through many months of turmoil due to rising interest rates. The downward pressure on valuations is due in part to the Fed's response of keeping interest rates higher for longer to drive down inflation to the targeted 2% level. As much as CRE professionals in Chicago are eager for interest rates to come down, survey responses from mid-year showed most didn't expect rate decreases before mid-2025. Almost 80% of participants expected that inflation would range from 3% to 4% over the next 12 months, predictions that may be moot now that inflation has fallen below 3%.

The Bid-Ask Spread

According to capital market professionals, valuations aside, a significant gap in the bid-ask spread continues. Real estate professionals are essentially unchanged in their expectation that the spread will narrow. In 2024, 46% hold that belief, up nominally from 45% one year ago. But perhaps more telling is that only 20% think the gap will widen, as opposed to nearly one third last year.

"We are seeing the bid-ask narrow, more sales are coming together, more and more of our payoffs are starting to come from asset sales," said Greg Warsek, Executive Vice President, Associated Bank.



More than six in 10 (62%), believe the narrowing will be caused by seller capitulation. Nearly 30% expect a meeting in the middle.

“Sellers will have to move more. The market has been unrealistic. Yet it has sobered up to realize the Fed won’t be coming to the rescue,” said Emi (Maiko) Adachi, Managing Director, Co-Head of Global Investment Research, Heitman. She also said that buyers must be disciplined and realistic.

Yet some buyers are more aggressive. They’ve adopted the mindset, “If there is a clear path to generating income, we’ll make the deal.”

The “R” Word

The survey found interesting perspectives on expectations of a recession.

At this time in 2023, 32% of participants believed we were already in a recession. In 2024, that number was only 18%. Further, 43% now believe we will avoid a recession altogether. Last year, less than 12% believed that. While that appears promising, in 2024, 28% believe a recession could occur next year, in 2025.

According to Jim Shilling, the George L. Ruff Endowed Chair in the Real Estate Center at DePaul University, while the landing has been smooth so far, there are concerns about the appropriateness of the Federal Reserve’s current interest rate policies given the state of the economy.

A REVIEW OF RECESSION & INFLATION

INFLATION: Do you expect the Fed’s decisions to result in the U.S. making a:

"HARD" ECONOMIC LANDING 17%

"SOFT" ECONOMIC LANDING 55%

I AM NOT SURE 28%

RECESSION: What are your future expectations about a potential recession?

18% BELIEVE WE ARE ALREADY IN A RECESSION

11% EXPECT IT DURING SECOND HALF OF 2024

28% EXPECT IT DURING 2025

43% BELIEVE IT WILL BE AVOIDED

Source: The Real Estate Center at DePaul University and Urban Land Institute Chicago District Council

“The smooth landing in the U.S. so far has been attributable to the Federal Reserve’s cautious approach to managing interest rates and a strong job market,” he said. “If economic weakness is indeed coming, the Fed may regret not starting to cut interest rates in January 2024, as it can take 18 months for a change in monetary policy to impact the economy.”

He suggested that those holding this view would expect a hard landing in 2025. “In contrast, if the Federal Reserve’s cautious approach continues to prove effective, this could explain why 43% of the respondents in our survey believe we will avoid a recession altogether,” Shilling added.

RISK FACTORS: THE BIG VIEW

Commercial real estate has location-specific issues and trends that can make it both challenging and opportunistic to invest in and manage any type of property. At the same time, no company or professional operates in a vacuum; their decision making will be influenced, to one degree or another, by issues that are occurring on the national and worldwide stages.

While three of the top four macro risk factors directly correlate to economic and related conditions, the number one macro risk factor is the current political climate. It ranked a 4.06 out of 5.0 and was the only one of nine risk factors to score above 4.0. The next closest issue - inflation - scored a 3.68.

With inflation slowing and interest rates likely falling in September, the toxicity of the political climate, through the election and beyond, will continue to be a major factor moving forward.

CHICAGO-STYLE RISK FACTORS

Fewer things are more predictable in Chicago than a green Chicago River on St. Patrick's Day, the heartbreak caused by at least one of the city's professional sports teams or Cook County property owners (commercial and residential) taking issue with their latest tax bill.

True to form in 2024, commercial real estate professionals ranked safety (crime) and taxes in Chicago as the top short- and long-term challenges. In fact, the ranking for safety and property taxes as top short-term challenges increased year-over-year. Safety scored a 4.38 out of 5.0 and property taxes scored a 4.32. Last year they were just narrowly more than 4.10.

Interestingly, when taking a long-term perspective, property taxes—along with pension issues—scored a 4.55 (out of 5), followed by safety at 4.3 and the City budget at 4.25.

Participant's view of Chicago's crime problem runs the gamut. There are those who say that crime may be one of the most serious matters because it's an issue you can't underwrite, whereas you can make educated calculations on taxes. Others point out that Chicago is a major city that has crime just as other major metropolitan areas do, not materially better or worse than other large U.S cities.

But perception matters when trying to attract capital or tourists. It is important that Chicago not only addresses the issues but is also seen to be doing so. In part, as Zeb McLaurin, McLaurin Development Partners, suggests, Chicago is a city in need of a major branding program that can extol its many virtues and counter misconceptions that continue to plague its image.

CITY OF CHICAGO CHALLENGES: What are the great challenges that Chicago faces? Assign a number from 1 (lowest) to 5 (highest)

NEAR-TERM

Challenge	Score
Safety	4.38
Property Taxes	4.32
New taxes (eg. transfer tax redux.)	4.07
Lack of interest from capital (debt and equity)	3.70
Vacancy rate/return to office	3.64
Bank safety	3.32
Other	3.21

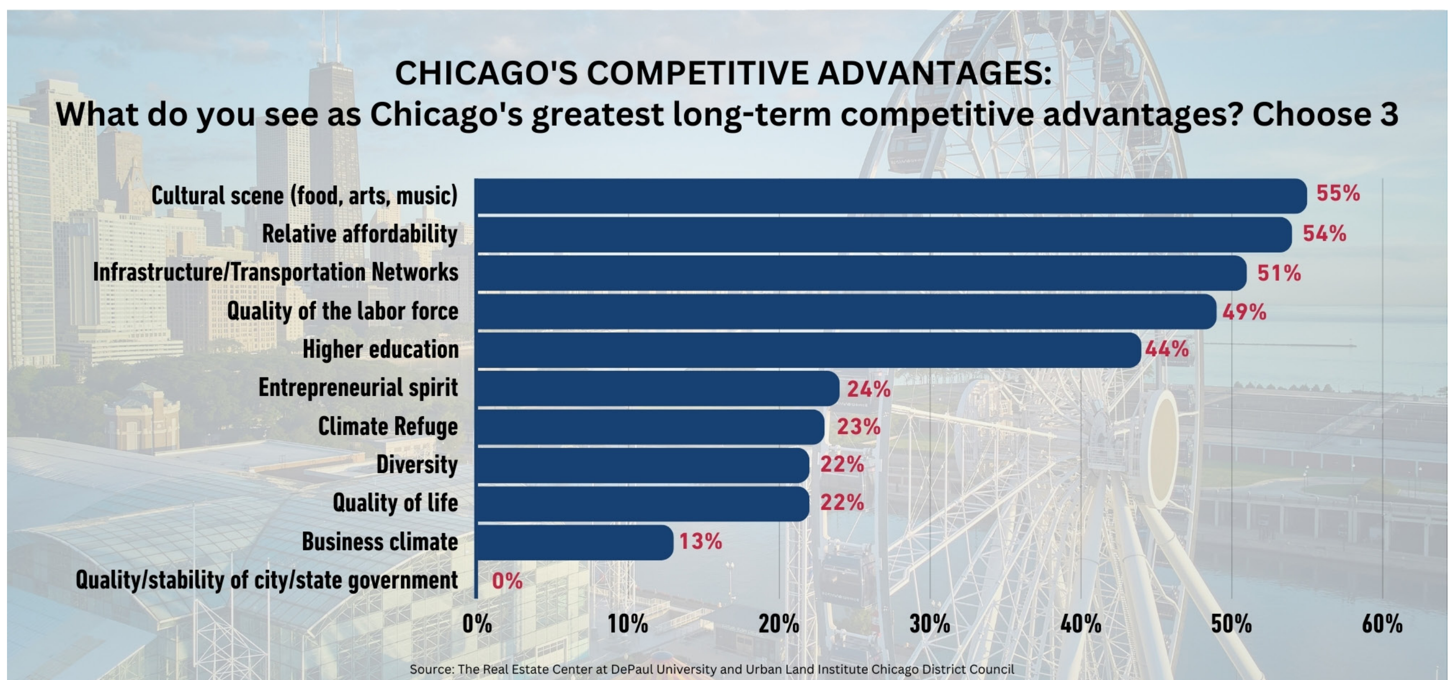
LONG-TERM

Challenge	Score
Taxes/Pensions	4.55
Safety	4.30
Budget	4.25
Schools	3.96
Housing Affordability	3.37
Talent/Population Loss	3.18
Transit	3.17
Roads	2.93

If Chicago were to develop and execute an aggressive public relations and marketing campaign as has been suggested, more than 50% of survey participants believe that its cultural scene, relative affordability (especially when compared to the coasts), and infrastructure and transportation networks are Chicago's greatest competitive advantages. Those attributes were followed closely by the quality of the labor force and the huge array of higher education options not just in Chicago but throughout the Midwest.

Ironically, the lowest rankings among Chicago's greatest long-term competitive advantages were its business climate, selected by 13%, and the quality/stability of the city and state government, which wasn't cited by any participants.

Fiscal issues are always a problem and a potential threat to whatever momentum is being made. "The administration has to work with the business community," Adachi said. "It can't be the old way, business as usual; they must find new sources of revenue."



With crime, it's a lot about perception. There are certain types of crime that stick in your mind. And while many types of crime are down across major metros, the police and the administration need to show a thoughtful response and achieve results to change public perception.

"Taxes are an issue and a discussion point, one that typically has far more uncertainty than clarity. However, this is only one area of analysis for investors; rent growth, population growth, and other expense line items can have a bigger impact on valuations" Keith Largay, Senior Managing Director, JLL Capital Markets, said.

Investors typically understand there are differences between the initial assessed valuation and the figure settled on by the Board of Review. They also understand that changing a tax bill, or the entire system, is an arduous, convoluted and very expensive process.

According to O'Keefe Lyons & Hynes, a property tax firm in Chicago, the early figures for the city's Triennial reassessment show that commercial property valuations have increased significantly across all asset types when compared to figures for 2023.

In one township, for example, the increase for general commercial buildings, industrial and retail properties was 23.95%, 67.2%, and 13.67%, respectively.

"This is a challenging environment for landlords, as they have to raise rents to cover their tax burden," Kevin Hynes, Partner, O'Keefe Lyons & Hynes, said. "Yet, there is a fine line between how much landlords can pass along and how much they can absorb."

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Value in real estate is challenging to define.

It means different things for different people, depending on the use. The underlying objective: don't leave anything on the table or put too much there to start.

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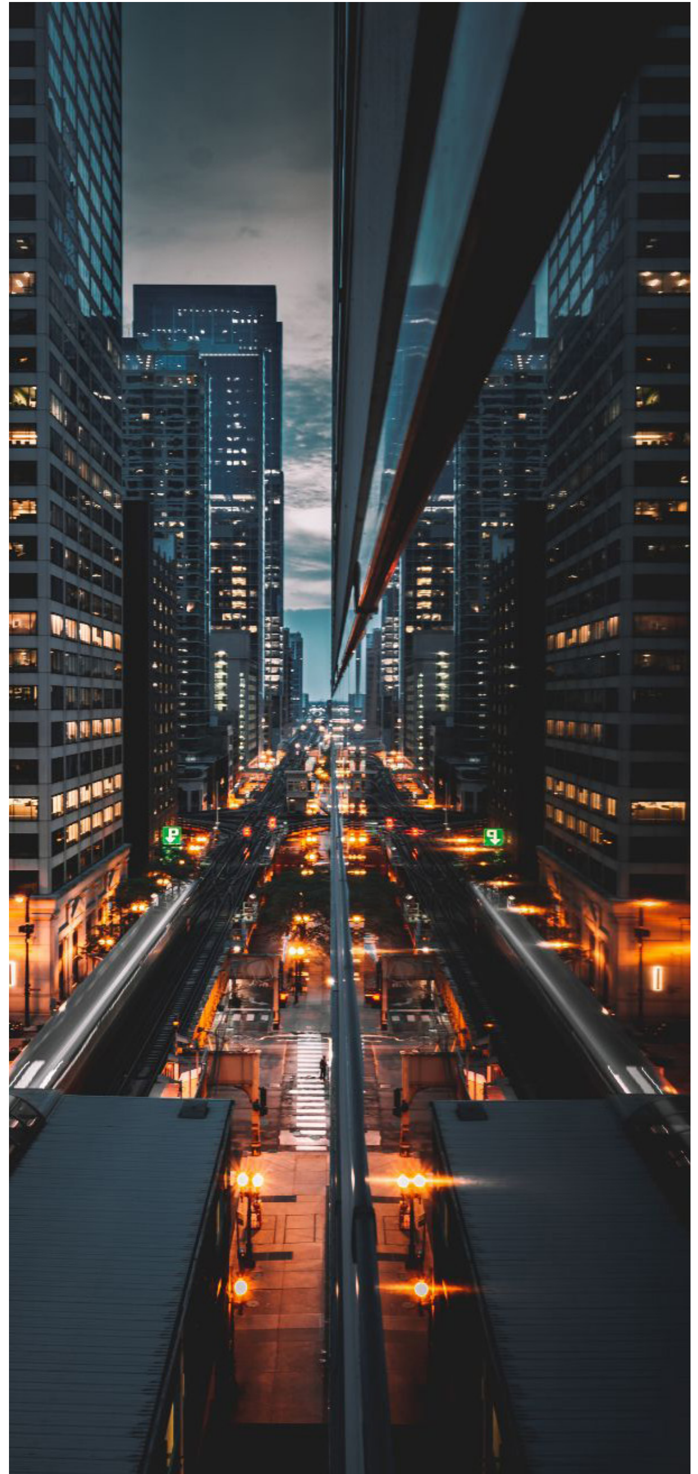
THE DEVELOPERS' VIEWS OF DISTRESS, OPPORTUNITY & SLEEPLESS NIGHTS

"A significant reset is happening, in Chicago and markets across the country," said Regina Stilp, a Founding Principal, Farpoint. "We are at an incredible inflection point in the cycle to buy in Chicago. But getting in at the right basis is critical."

Michael Reschke, Chairman and CEO, Prime Realty Group, doesn't believe it is an exaggeration to say that more than 50% of the commercial buildings in the City could be purchased at distressed pricing today. But the development and investment community doesn't have a "bottomless pit of cash." So they are being selective, picking and choosing the assets they want to pursue.



Stilp said despite negative perceptions, the office is not going away. "There is a blend for how it is being used. The primary way to assess the viability of an investment is its location and the basis going in."

Quintin Primo, Founder and Executive Chairman, Capri Investment Group, agreed with Stilp and said the initial cost basis is critical and will govern what you're able to do it in terms of repositioning the asset, whether for residential, hotel or any other use.

"From a debt and equity perspective," Stilp added, "there is no magic pill."

"I think there's a growing realization from both lenders and owners that valuations are depressed and going to remain depressed for quite some time," Primo said. "Virtually any building in the Central Loop is an acquisition opportunity with the potential for redevelopment or a conversion."

Reschke says the idea that every "empty" office building has to be converted to something else probably isn't true.

"Calling these office buildings obsolete is a misnomer," he said. "They're just vacant and we have an excess supply of office space. But you can take an old office building and invest capital and make it great; it is happening."

Reschke gave the example of the Jeweler's building that Prime just acquired and said they have no intention of converting it to anything. Instead, the plan is to invest some money to add a nice restaurant and conference center, with terraces, and prime amenities.

Stilp, a lifelong Chicagoan with a penchant and a vision for redeveloping and repositioning projects, believes Chicago is on the right track in the reset. She's optimistic.

"In the past 10 years, we've had three different mayors with different agendas and priorities," she said. "That's not good for continuity. Yet public officials are working hard to cut the red tape, and to make it easier to get projects approved, started and finished."

"We need cranes in the sky, and we're not there yet," she said. "But we'll get there."

Primo's optimism is bolstered by the state of the overall economy, which he characterizes as good. "The overall economic conditions in the market are strong and serve as a positive backdrop," he said. "That provides a good tailwind for the real estate markets as they continue to recover."

Reschke is perhaps as bullish about Chicago as ever, saying, "Our strengths, from our public transit system and our educated work force to our affordability, park system and lake front make us one of two world-class cities in the U.S."

"That's why a vast majority of college grads coming out of Midwest universities want to be in Chicago for the first part of their careers," Reschke said. "They don't want Detroit, Columbus, St. Louis or Kansas City; they want to be in Chicago."

While these developers and investors generally are optimistic, there are forces shaping the market that stand out as issues capable of keeping industry professionals up at night.

"I'd say the two biggest problems are controlling crime and the pension plan problems," Reschke said.

Primo addressed issues that are bigger and more national and global in scope.

"The general divisive tone of the nation right now is America's greatest issue," he said. "Economically, we're doing really quite well. We're still the largest economy in the world and will continue as such for decades to come."

That divisiveness he perceives as lowering rather than heightening the country's ability to grow.

INVESTING IN CHICAGO'S FUTURE & ASSETS

The Billion Dollar Question

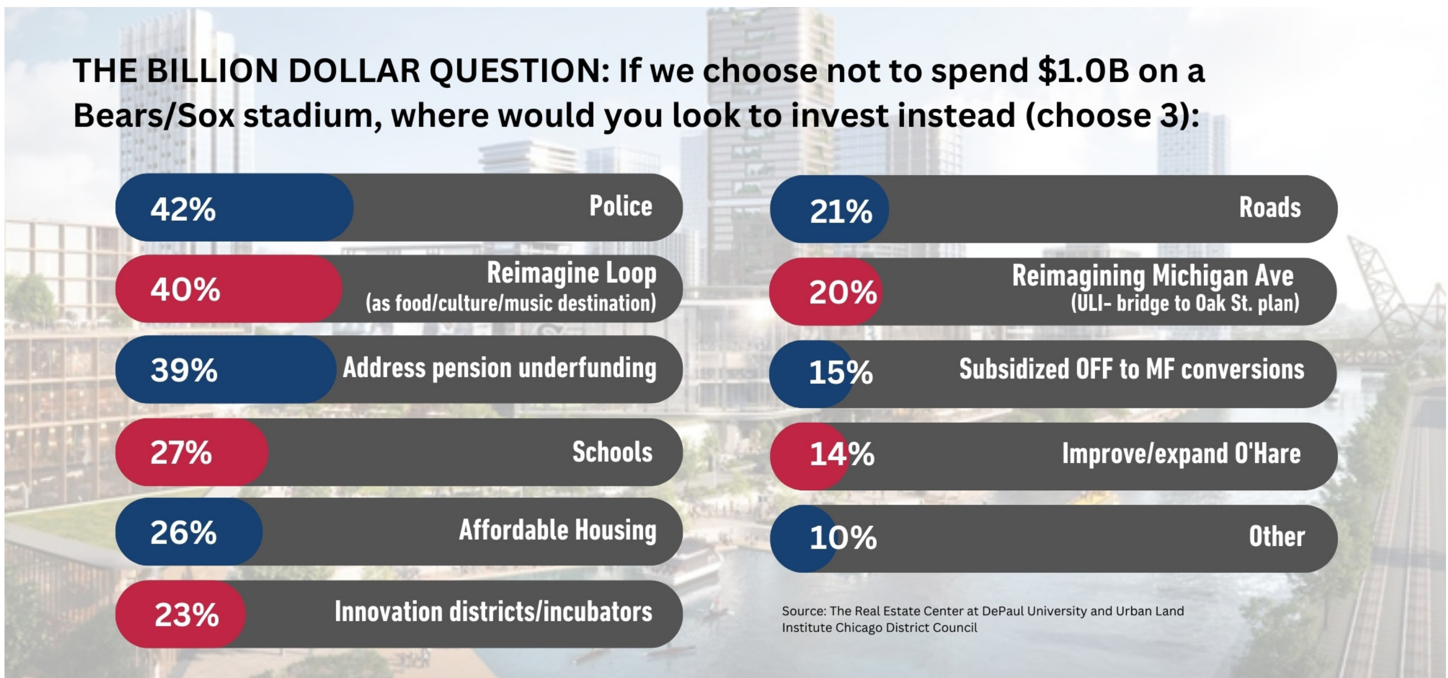
For more than one year, the real estate community and sports talk radio programs have hosted spirited discussions on the issues, challenges and costs of new stadia. It's been a hot topic as the Chicago Bears invested in land in Arlington Heights and scouted numerous other locations in and out of the city. More recently, Jerry Reinsdorf via his proxy Related Midwest, the group behind "The 78", made a case for a using public dollars for a new baseball stadium, intended to help anchor the megaproject located south of downtown.

The price tag could reach into the billions, but the soft pitch to Governor Pritzker for a state subsidy has been closer to $1 billion, give or take $100 million. With that pitch seemingly going nowhere, survey participants were asked if not a stadium, where would they spend $1 billion?

"Given the short and long-term Chicago area challenges identified in the survey, it is little surprise that a primary focus among CRE professionals is to attack real problems or weaknesses and invest in the strengths of Chicago," Pratt said. "The Chicago real estate community isn't ready to be in the vanguard of a defund the police strategy."

Rather, respondents advocate practical solutions both near and longer term although they remain skeptical that compromise will be easy given the current political climate, locally and nationally.

More than any other option given, 42% chose financing police department improvements. A close second and third, at 40% and 39%, respectively, were reimaging the Loop as a food, culture and music destination, and meaningfully



addressing pension underfunding. While there was a substantial drop-off to the next tranche of selections, schools and affordable housing did crack the top five categories for increased investment.

As interested as real estate professionals are in reimagining the Loop, they are less inclined to support efforts to reimagine Michigan Avenue or subsidize the conversion of office buildings to multifamily assets.

Developers active in the city offered some interesting perspectives.

"I would lower real estate taxes," Reschke said. "I wouldn't spend it."

If Primo had $1 billion to spend, he'd build cover decks over the expressways--one over the Dan Ryan Expressway between 31st and 35th Streets and the second between Jackson and Lake Street.

"It would cause connectivity certainly on the South Side, reconnecting a market that was divided perhaps unfairly by the expressway," he said. "That connectivity would produce economic development and jobs at the confluence of three of Chicago's greatest neighborhoods: Chinatown, Bridgeport, and Bronzeville."

"Connecting cultures and real estate would allow these communities to flourish," Primo emphasized.

Reschke added that under such a plan, you could leave the baseball field there, "Then there's no argument to build a new stadium."

McLaurin isn't necessarily opposed to spending money on a new stadium.

"Nothing brings a community together like sports, and in this town, Bears football," he said. As a result, he doesn't think it should be a question of can it get done, but rather where it should get done. "If not located correctly, it becomes a wasted public capital expenditure."

McLaurin also suggested that before $1 billion is spent there should be an "audit" of where other major public dollars have been spent to ensure that the return on investment that was pitched in securing projects like Millenium Park and McCormick Place, for example, was achieved.

"As we celebrate the 20th anniversary of Millenium Park, the City has the opportunity and obligation to examine its true economic benefit to the area before it spends any significant capital," he said.

Underscoring the importance of spending resources wisely, he cited significant, largely unreported structural issues at McCormick Place that if left unaddressed could have significant repercussions to Chicago's standing as a convention center. "If we don't take care of the assets we own and rely on, we are assuming unnecessary risk," McLaurin said.

Investing in Chicago—Its Real Estate

As part of the DePaul-ULI survey and interviews, capital markets sources were asked how they would allocate a big Chicago property acquisition spend.

Adachi would invest approximately 25% in industrial property, 20% in apartments, 10% in grocery-anchored centers, and 45% in alternative sectors including self-storage, medical office and senior housing.

Largay's allocation would also be anchored by investment in industrial real estate—as much as 50%. But that's where the similarity ends. He said he would also go big, potentially as much as 50%, on core multifamily assets in part because some have been discounted and priced at 20-25% below replacement cost.

"Chicago apartment buildings are seeing rent growth, and we've gone from 35 cranes in the sky to only two, so a shortage is coming," he added.

Largay would potentially allocate 5-10% of a spend on opportunistic purchases, like a core office building that could be available at a deep discount—as much as 50% or more.

Warsek responded that if a client of his had significant equity to invest in the Chicago marketplace, the property types his bank would be most inclined to finance would include three asset classes: multifamily, industrial, and retail. Warsek suggested it would be possible to underwrite loan-to-values (LTV) in the 55%-75% on multifamily and industrial and closer to 65% on retail.

"But it would all be dependent on factors such as new construction vs. existing properties, spec vs. build-to-suit, and tenant quality."

SECTOR PREFERENCE: IT'S ALL RELATIVE

The survey's ranking of best investment opportunities among 13 commercial sectors resulted in subtle year-over-year shifts, but as a rule remained much the same. Data centers, industrial assets and suburban multifamily scored the best, suburban and downtown office were the worst.

When 13 different property sectors were rated on a scale of 1 to 5, with five being the highest, the average for the 13 sectors was 3.06, down slightly from 2023's average rating of 3.16.

The most notable change: the data center rating went up and the industrial score went down, which jumbled the order from 2023 to 2024. Data centers became the highest-rated sector at 4.25 after an increase from 4.01 last year. The decrease for industrial real estate was substantial, to 3.7 from 4.29 as the sector moved to third place in 2024. This largely reflects concerns about near-term supply levels for the industrial segment, rather than any long-term erosion of demand fundamentals.

Ranking of Sector Types

SECTOR	RATING (ON A SCALE FROM 1-5	CHANGE FROM 2023
DATA CENTERS	4.25	↑
SUBURBAN MF	3.78	→
INDUSTRIAL	3.7	↓
SR HSG/HEALTHCARE	3.6	↑
DOWNTOWN MF	3.44	↓
STUDENT HOUSING	3.27	↓
SELF-STORAGE	3.26	↓
LIFE SCIENCES	3.14	↓
LIFESTYLE SC	3.12	↑
HOTEL/HOSPITALITY	3.03	↓
ENCLOSED INDOOR SC	1.82	↑
SUBURBAN OFFICE	1.74	↓
DOWNTOWN OFFICE	1.67	→

Source: The Real Estate Center at DePaul University and Urban Land Institute Chicago District Council

Data Centers

According to Jim Kerrigan, Founder, North American Data Centers, the consistent performance and appeal of data centers as a sector can be attributed to a variety of factors, including the expansion of AI platforms and capabilities.

"In major markets like Chicago, Dallas and Northern Virginia, increasing demand tied to AI really took off at mid-year 2023 and continues," Kerrigan said. "Of the major markets, Chicago remains among the top five."

He noted that previously, the demand drivers were companies like Google, Oracle, Apple, Meta and Microsoft, among others. Today, demand is broader, reaching beyond the large enterprise users. This can result in different types of data center demand, including centers that are geared more to multi-tenant colocation users.

At the same time, Kerrigan said his greatest long-term concern for the sector relates to fundamental infrastructure matters, like the ability to deliver power to a site and the availability of the equipment and components necessary. He also said the potential for AI-related regulations could impact the sector.

Industrial

Two prominent investment and development firms in Chicago are bullish about the industrial marketplace, notwithstanding its slide in the ratings of the sectors.

This is in large part because of the diverse base of industrial users fueling the market.

Caitlin Sullivan, Senior Vice President, Link Logistics, cited NAI Hiffman statistics revealing that in the first quarter, the actual lease transaction count was up by 20% even though leasing square footage was down approximately 15%. That trend can be attributed to the active user base, which includes manufacturers, light assembly and suppliers, occupying smaller footprints.

“It’s not just third-party logistics (3PL) and enterprise user driven,” Sullivan said. “It’s all part of the larger ecosystem and continues to be driven by more local and regional business activity.”

For much of the industrial market’s long and historic run, a lot of activity was headline-grabbing. It was million square-foot developments and leases and large portfolio acquisitions. Today’s sweet spots, according to the experts, include buildings that range in size from 100,000 to 300,000 square feet or, from a purchase perspective, $20 million to $30 million.

Aaron Martell, Executive Vice President, Logistics Property Company, said his view has shifted and he feels positive about the market. “I feel better about the market than where we were six months ago and I feel even better than three months ago.”

Martell attributes that, in part, to the lack of fluctuations in interest rates. "In order for long-term investors like LPC to feel strongly about the market, transaction volume needs to be occurring from the leasing and capital market side."

While rates haven't gone down through early September, as had been expected, they haven't fluctuated for the last nine months. That gives investors a greater level of comfort, which is needed to complete transactions.

"We've always deployed the strategy that if a deal presents itself, you make the deal; you don't get cute or try to over negotiate," Martell said. "Do a fair deal and move on to the next one to fill your vacancy."

That strategy has further credence in today's market, compared to a couple of years ago, when there may have been 10 users lining up for a space instead of perhaps only a couple now. When looking at the Chicago market from a historical perspective, the vacancy rate is below the historical 10-year average, Sullivan said.

A rapidly increasing level of capital market activity is Martell's greatest source of optimism for the industrial market over the long term.

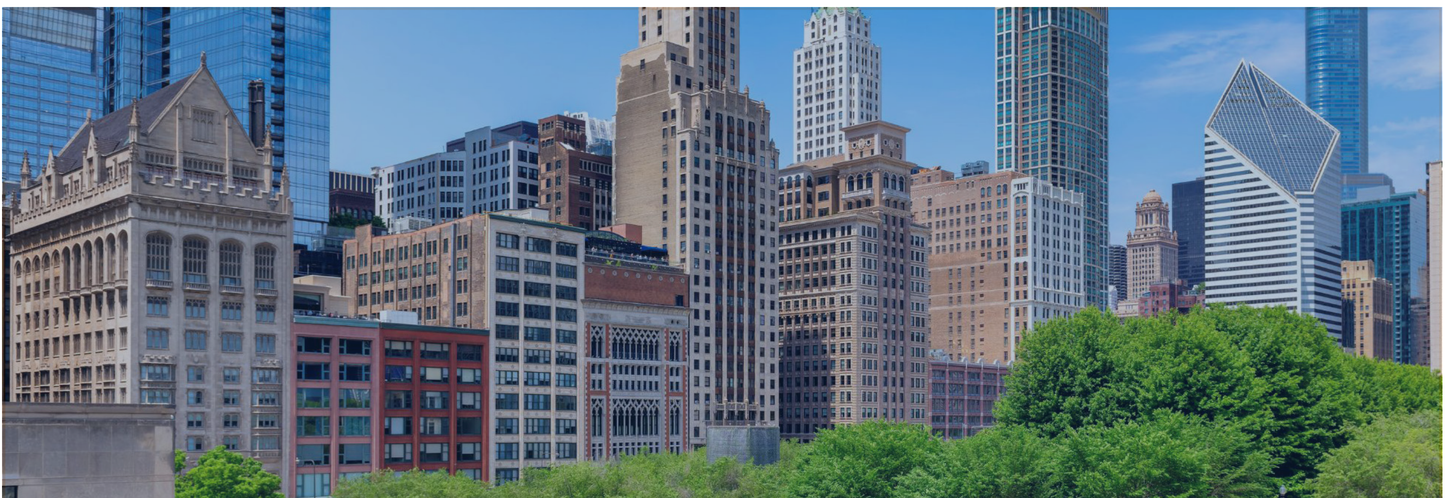
On the flipside, concerns for the market include something of a lingering supply issue, a result of what Martell calls commodity development and the belief that regardless of where buildings were developed, they would be leased. Commodity development increases the possibility of buildings staying vacant for longer.

"That creates somewhat of a contagion that puts downward pressure on rental rates across the market, even the well-located Class A product," Martell said.

Sullivan suggests a lot of development can continue to happen on the outer edges of the markets, as you continue to go into more Suburban areas. "We tend to concentrate on the infill locations, but those are harder and harder to develop."

Creative developers are trying to aggregate functionally obsolete assets and alternative product types to accommodate modern product within infill locations. As these sites are amassed, traditional submarket lines and market areas are being blurred.

"We are well built-out within the inner rings of Chicago industrial," she added. "There are opportunities, and I think we're in a good place to absorb some of the spec that's currently out in the market and benefit from the lack of activity and construction going forward."



Multifamily

Multifamily assets in suburban and downtown Chicago remain among the top five investment opportunities in the region, according to the survey results. Market dynamics and fundamentals point to a strong long-term outlook. At the same time, the interest in the asset class, like other segments in Chicago, comes largely from people and firms with deep Chicago roots, and strong local market knowledge.

According to Vicky Lee, Senior Vice President, Development of Chicago-based Focus, there hasn't been a lot of change over the past 12 months in outside investor interest. "The combination of a high interest rate climate and a degree of uncertainty with property taxes continues to cause a redlining of Chicago with many outside investors unwilling to consider opportunities here."

Yet she remains very optimistic about the Chicago marketplace over the long term. "Once there is a sign of interest rates coming down, and if it is a sustained trend, I think things will start to open up," Lee said, adding that it's hard to know when that will happen.

According to Jerry Lumpkins, Senior Vice President, Valley National Bank, multifamily properties, particularly suburban assets, represent a favorable asset class for lending purposes. "You can't outsource where you live," he said. "If you are in a Class A building and you lose your job or have financial difficulties, you downsize to Class B."

In the long term there are many reasons to believe in Chicago and its multifamily sector. The City has a strong employment pull for Big 10 college graduates and is generally more affordable than coastal markets. Further, it is a vibrant cultural center with distinct neighborhoods, world-class restaurants, and top entertainment vibes. Another cited positive is Chicago's growing presence as a life sciences hub, driven in part by both public and private sector activity.

One area where Lee believes opportunities lie is in mixed-use development, specifically augmenting existing retail experience with residential uses and new public spaces. "It depends on the specifics of the market and of the retail center," Lee said, "some have winning potential while others don't."

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In the Chicago area there have been a considerable number of mixed-use developments, completed or in varying stages of the development process, that feature the integration of a multifamily component. The key is creating synergies between the retail and residential components– think live/work/play - in markets with supportive fundamentals.

In 2025, Focus expects to begin construction on 400 apartments at Old Orchard Mall, an iconic mall in Chicago's northern suburbs. Recently, Old Orchard has undertaken a repositioning of the retail space which includes the renovation of the existing Lord and Taylor box, the addition of a Bloomie's and Louis Vuitton, and more. The addition of a multiphase multifamily community is being led by Focus, and is based on the company's experience redeveloping portions of Fox Valley Mall in Aurora, portions of Hawthorn Mall in Vernon Hills and The Atworth at Mellody Farm, also in Vernon Hills.

According to Lee, all three projects enjoyed strong lease-ups with tenants citing the benefits of an urban environment in a suburban setting. "Walkability to grocery stores, restaurants, and entertainment are very attractive amenities,“ she said.

Much has been made about how buying a home has become increasingly more expensive. Yet according to Helen Bailey, Founder and Managing Broker, Pioneer Realty Group, there are reasons for optimism in the last half of 2024 and into 2025.

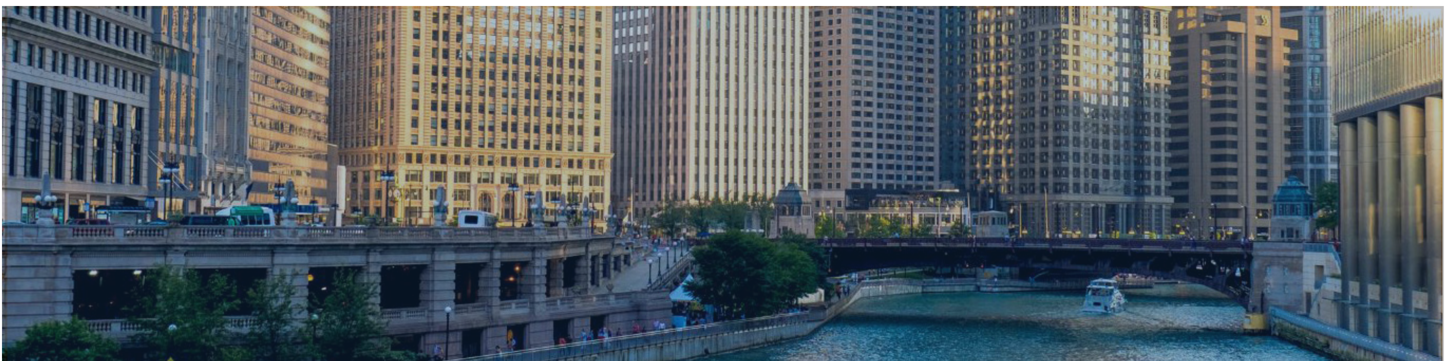
"People have been holding back because of rate and election year uncertainty," she said. "However, with interest rates already on the decline and more expected through year-end, we expect that the landscape will be financially more conducive for sellers to list their homes and buyers to be in a position to make a purchase."

The Office Sector

According to recent statistics from Kastle Systems, an increasing number of people are going back to the office. Chicago recently recorded a day when occupancy reached 681%.

That written, the downtown and suburban office markets are currently viewed as presenting the least favorable investment opportunity among all CRE sectors in Chicago. According to experts including Adachi and Largay, the office market in Chicago is a multi-year issue, but in reality, it isn't any better anywhere else.

Adachi likened today's office market environment to the challenges that regional mall owners and investors have faced for many years. It's a long and painful process to right size, reposition and reimagine assets that were a fundamental component of commercial real estate.



"As experts have been lamenting for several years now, it is a bifurcated market, in Chicago and most markets across the country," Largay said. "Trophy product is experiencing record rent levels and rate increases."

But among the bears, a few out of consensus bulls are sniffing for opportunities in the Chicago office market.

"The hybrid work model is here to stay, but it isn't going to be about coming into the office whenever people want to be in the office," Primo said. "My guess is the workplace will return ultimately to four days a week."

But for some, the number of employees that are back in the office is not enough. Because of the pandemic shutdown and the work-from-home policies companies adopted, many people in real estate and business believe that employees got spoiled.

"Six years ago, in a normal environment, it would have been unheard of to let employees dictate whether they're going to come to work or not," Reschke said. "We have to get over that."

Employers are having a hard time from an employee relations standpoint forcing people back to the office five days a week. However, there is widespread agreement that the key to the vibrancy of the downtown workweek is getting people back to the office.

"It might take a recession for people to start realizing how important their jobs are and how difficult it is to get another job. Then they might be more appreciative of the work environment," he added.

Reschke and Primo agree that it could take another several years to get to that and, as Reschke said, "flush it out of our system."

At the opposite end of the spectrum, older commodity buildings are suffering. The fundamental changes in the office sector have hit values in three different ways:

- The significant drop in demand—and corresponding increase in vacancy
- The cost and availability of both debt and equity capital and,
- Increasing demands for expensive tenant improvements (TI) from potential tenants who have stronger bargaining power amid higher market vacancy. This can be particularly challenging for poorly capitalized building owners who certainly do not have equity to fund the TI. Lenders too are much less willing to provide the debt capital needed to fund TI or leasing commissions. The result can be low occupancy in a building that could still attract tenants, were it in the hands of a better capitalized owner.

It's an entirely different scenario from what the market experienced pre-Covid during the days of free money and free debt, Largay said. As a result, values may be down 20%, 40% or more.

"Trophy Class A office buildings will survive," Hynes said. "It's the Class B and C buildings, and we have a lot of them in the City, that are struggling right now and will for the foreseeable future."

Most in the industry agree that any owner with a building that may be worth only cents on the dollar, truly wants to sell. The sales are lender-driven because with so much uncertainty in the sector, few if any lenders want office investments on their balance sheets.

Retail

Segments of the retail sector continue to benefit from a reset that started before the pandemic and then became more critical as centers had to evolve or become extinct.

Common strategies, paths that remain prevalent today, have been adding residential components and focused attention to experiential elements that broaden the focus and appeal of malls. Further, although not a new strategy, grocery-anchored and need-based centers have remained very popular investment options, especially as some shakeout occurs in the grocery sector.

“Broadly speaking, retail is in a very good state operationally,” said Adam Tritt, Chief Development Officer, Brookfield Properties. “As far as the overall market, we’re all a little constrained by rising interest rates and we’re seeing that impact everywhere.”

Brookfield’s Oakbrook Center is an example of a center that hasn’t needed to add apartments to reach standard measures of success. According to Tritt, the Center continues to see sales gains and recently surpassed $1 billion in total sales.

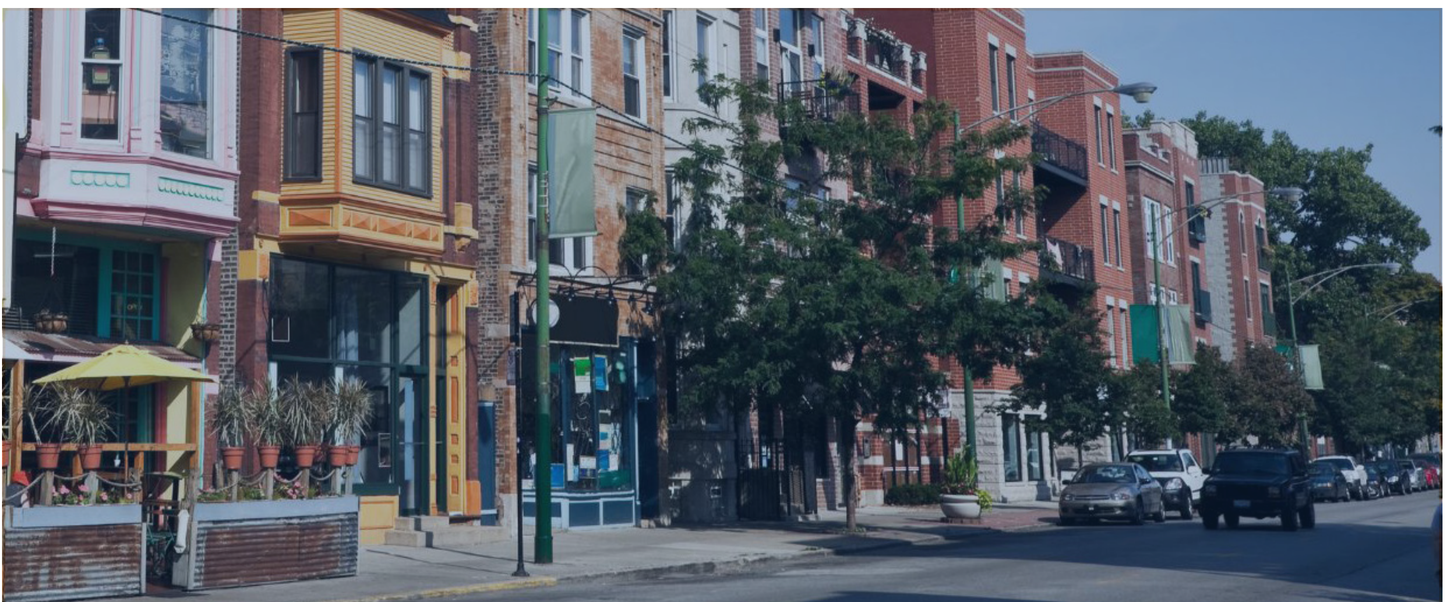
Despite success stories, CRE professionals ranked retail properties among the weakest property types—better than office but not as good as self-storage—for investment.

“Retail is an interesting asset class whether it’s a purely retail or an asset with a strong retail core,” Tritt said. “You must view them as living breathing organisms that need a constant level of care and touch.”

Treating the retail asset as a living, breathing organism and making sure public spaces are being managed to ensure positive experiences emotional connections with visitors are created pays dividends, regardless of the point in a cycle.

“There’s plenty of room to find success as long as you’re committed to caring for that asset and trying to work the best out of it,” he added.

Over the last five years, there have been major retail property redevelopments that added multifamily properties to the mix. Yet adding apartments isn’t always the answer and may not be a difference-maker.



Oakbrook Center, for example, doesn't have multifamily but has mixed-use environment with hotel and office properties on site. Other advantages include having immediate adjacencies to residential communities, research corridors and major expressways and thoroughfares.

"Is multifamily going to be part of some of those success stories? Absolutely," Tritt said. "Is it a must have? Of course not. If you're talking a retail property the size of Oakbrook, apartments totaling 300, 600, or 1,000 units is not really going to move the needle."

While metro area malls have flourished with or without apartments, there have been several prominent malls in the Chicago area, including Stratford Square and Spring Hill Malls, that closed permanently. That points back to the concept for any retail investments that if an asset has been overlooked for an extended period of time, it could face a long road to recovery. Further, at some point the opportunity runway gets shorter and shorter.

One of the most exciting things about this moment in the sector is that most have almost completely abandoned prototypical solutions. The solution for each asset is bespoke to its marketplace: the broad market that supports it economically and the closer-in community that lives with it every day.

"As a developer/owner, that's super fun because there is no one recipe for success," Tritt concluded.

THE BANKING VIEW

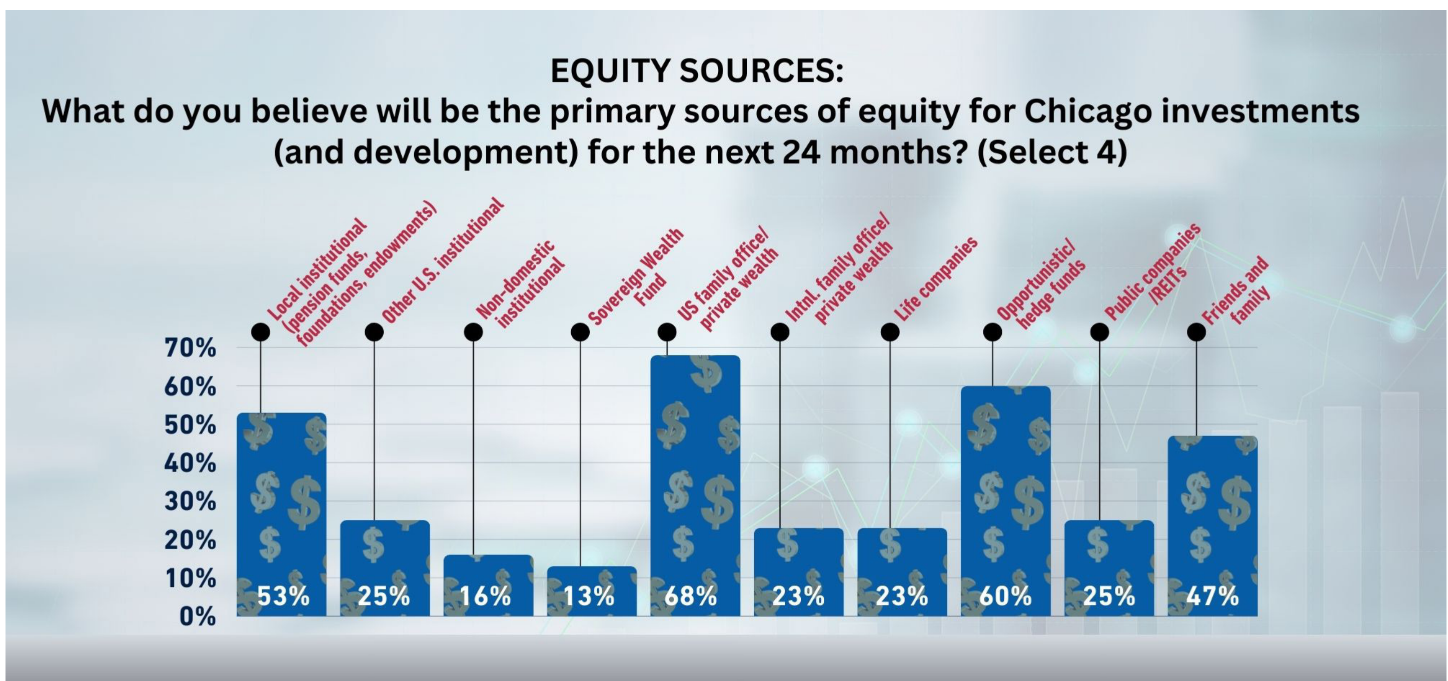
From the perspective of banking professional Lumpkins, the state of the market is "somewhat weird," and characterized by low unemployment, but higher interest and inflation rates.

"The market is in correction now and has been for 18 months," he said. "It's still in the early innings until we get back to the center of normalcy."

At the same time, others in the banking industry express that business continues, is working through the confusion and becoming increasingly more active. This is characterized by many banks once again issuing term sheets for new business opportunities.

"Now that interest rates have stabilized, we have a very optimistic outlook short and long term," Warsek said. "As short-term rates begin to decrease, we expect activity to intensify."

At the same time, institutional equity still hasn't come back in a significant way. It will take equity (institutional or otherwise) returning to increase transaction activity more significantly. As more borrowers accept the concept of higher rates for longer they are refining their business plans and projects to determine what will work. The expected outcome is that bid-ask spreads will begin to narrow, spurring transactions.



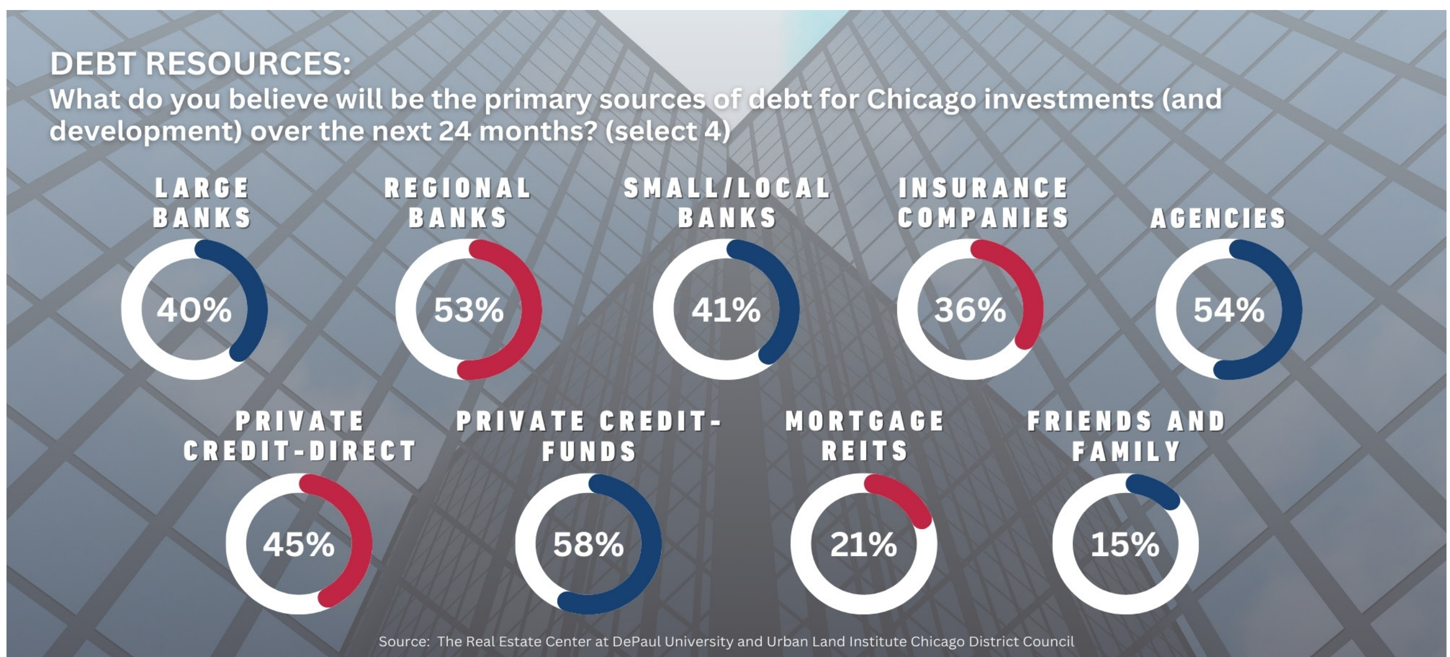
The correction has a lot of financial institutions parked on the sidelines, which is attributable to a number of factors. Some may be overexposed to real estate debt, especially given falling valuations that could fall further. With statistics suggesting there is more than $1 trillion dollars in recently or soon to be matured office debt, some institutions may have too much office property exposure that could be challenging.

That situation may be a contributing factor to the survey response that only 29% don't expect to see more bank failures in the next 12 months. More than 40% expect more failures and 30% aren't sure. The majority of survey participants offering a write-in perspective on the health of banks and whether there will be more bank failures ahead don't see it as a major force. One participant expressed the sentiment that there will be more failures, but in contrast to the Great Financial Crisis, we will avoid systematic risk. Others expressed that there may be a few, but the failures that do occur will be manageable.

In the challenging times caused by market conditions that currently exist, banks are keenly focused on existing long-term relationships.

"We continue to do more with our best clients," Warsek said. "The best clients are those that are loyal and recognize the importance of a true relationship. Clients that keep large deposit balances tend to have the largest lending capacity."

Lumpkins agreed and said, "We want deposits, cash management, and treasury services. We want to sell the whole bank versus simply doing a loan."



Borrowers, whether they are investors or developers, that view banks as a commodity or like a subcontractor tend to have limited options the tougher market conditions become. Warsek did say, however, that the current disruption in banking is creating opportunities to attract new high-quality clients.

Banking professionals echoed the common sentiment that the greatest concerns are real estate taxes, crime and the general business environment, and the negative impact each has on investor appetite to be in Chicago.

Warsek also said Chicago is a great city that continues to attract young college-educated talent each year. "It keeps most companies focused on our city."

CONCLUSION

As a sports town, the saying, “Wait until next year,” has an all too familiar ring in Chicago.

It’s the recognition that a team may be a draft, free agent signing or blockbuster trade away from being competitive. It’s the point where optimism reigns more prominent than pessimism…where challenges are more exciting than daunting.

At the mid-year mark, that too familiar sports tenet may be increasingly apropos for the commercial real estate markets.

Like many other markets, Chicago has experienced its fair share of knocks, since the pandemic. Yet the greater the distance these market conditions have in the rearview mirror, the easier it is to anticipate the road ahead.

Will Chicago’s CRE sectors be top performers in 2025? Will perceived risks, fail to materialize? Can leaders solve Chicago’s crime, pension, and property tax issues that impact outsiders’ views?

Probably not. But with;

- more people returning to the office, even on Mondays and Fridays,
- imminent interest rate cuts likely spurring companies to invest further in a Chicago presence,
- entrepreneurial developers, owners and investors daring to move projects from distress to impress,
- and each olive branch extended between red and blue; black, white and brown; man, woman and other pronouns; and haves and have nots,

we get closer today than we were yesterday. It’s not a quick fix that most in the industry would like. But it’s a starting point. And maybe there’s a championship parade in our future.

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DePaul University Honors Douglas Crocker II

Douglas Crocker II a respected and renowned commercial real estate executive, was recognized for the many ways he has served and continues to serve the DePaul University community. In June, Crocker received an honorary degree from DePaul University's Kellstadt Graduate School of Business and delivered a commencement address.

Crocker has been instrumental in the formation and success of DePaul's Real Estate Center. Because of a generous endowment, the title for Center's Director is the Douglas and Cynthia Crocker Endowed Director of The Real Estate Center.

He is a former university trustee and has provided numerous additional service and financial contributions. The Crockers have supported real estate education with scholarships for graduate and undergraduate students.

In his commencement address, Crocker told graduating students to expect the unexpected, work hard, learn from experiences, and never, never give up.

"The basic rules of the game can shift overnight," he reflected. "No matter how well-prepared you are – no matter how hard you work – you have to stay agile. You can't foresee every change. But you can adapt when the moment comes."

Douglas Crocker was conferred the honorary degree with a citation read by Sulin Ba, PhD, Dean, Driehaus College of Business and the hooding by Robert L. Manuel, PhD, President, DePaul University; and Salma Ghanem, PhD, Provos, DePaul University.

Crocker's commitment to DePaul University and the Real Estate Center is based on several factors, including that there may be students who are the first in their family to attend college. Further, as a global real estate executive, Crocker was familiar with renowned real estate centers in major metropolitan markets. He believed it was important to have one in Chicago, too.

"I believed Chicago, with all the great real estate and financial minds based and doing business here, needed to have a real estate center like they do at Wharton, UCLA, and other places," Crocker said. "I was happy and eager to get involved to help execute the vision that was being established."

Crocker, whose career spanned decades, may be best known as the Chairman and CEO of Chicago-based Equity Residential, which he formed and took public with legendary investor Sam Zell. The company grew quickly and was added to the S&P 500 Index. It is now one of the nation's largest apartment real estate investment trusts. Under Crocker's leadership, it ultimately grew to more than $16 billion in assets.

In looking back on his career, Crocker has no regrets and would have few do overs.

"There might be a few deals that I would reconsider, but good or bad, we learned a lot doing those transactions," Crocker said. "But I have had an incredible career, worked with some of the greatest minds in real estate and finance who also became good friends. I've been the luckiest guy in the world, why would I want to change?"

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