

National Commercial Real Estate (CRE) Update:

August 29, 2023

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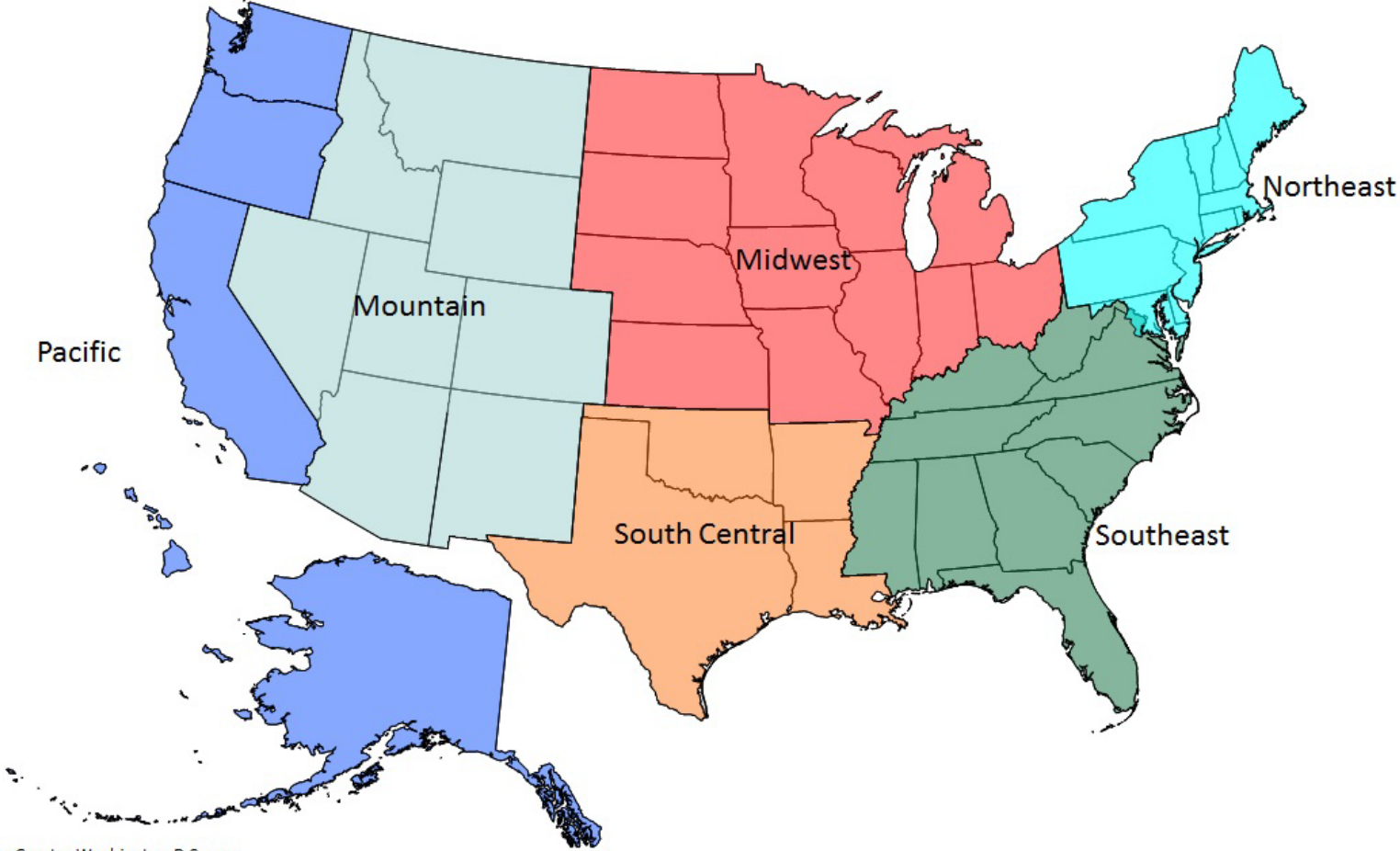
2023 National CRE Series

Regional CRE Updates

National
August 29, 2023

Mountain Region
September 27, 2023

Midwest
Northeast
South Central
Southeast
Coming in 2024



Note: Northeast includes the Greater Washington, D.C. area.

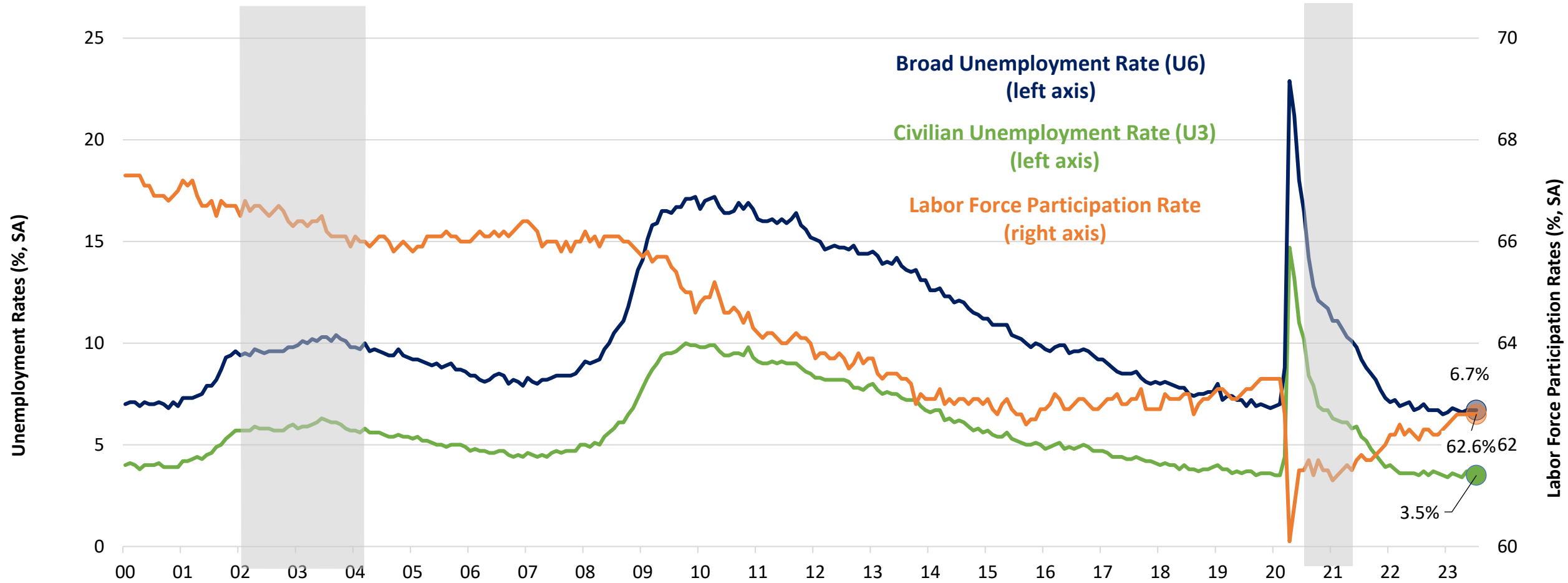
Session dates will be announced throughout 2023 and 2024. All sessions will be available at www.askthefed.org.

Polling Question #1

What is your biggest concern for CRE?

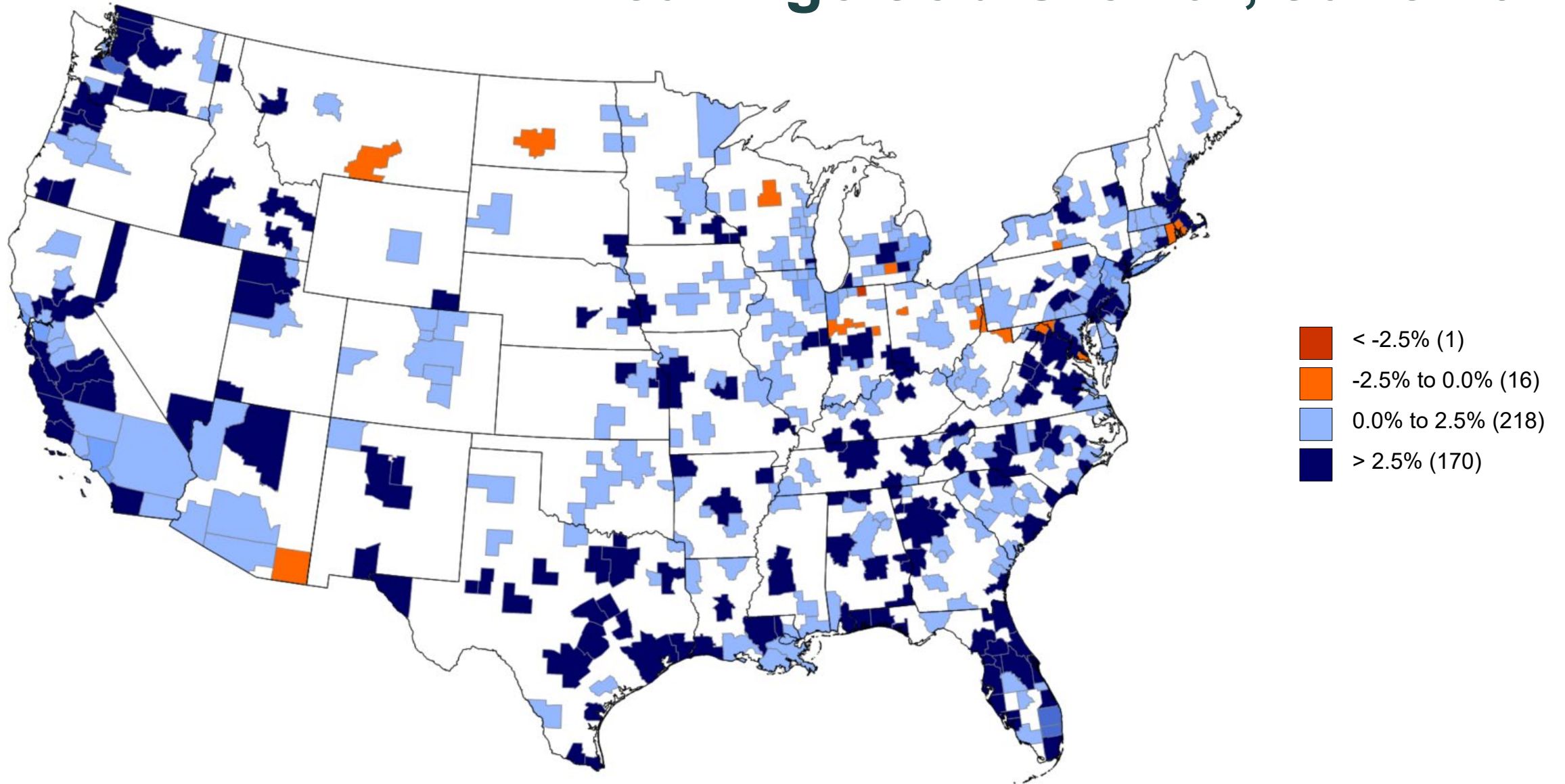
- A. Vast amount of loan maturities
- B. Rising interest rates
- C. Declining property values
- D. Availability of financing
- E. Stagnant/declining NOI
- F. No one is coming back to the office
- G. No idea

U.S. Unemployment Rates



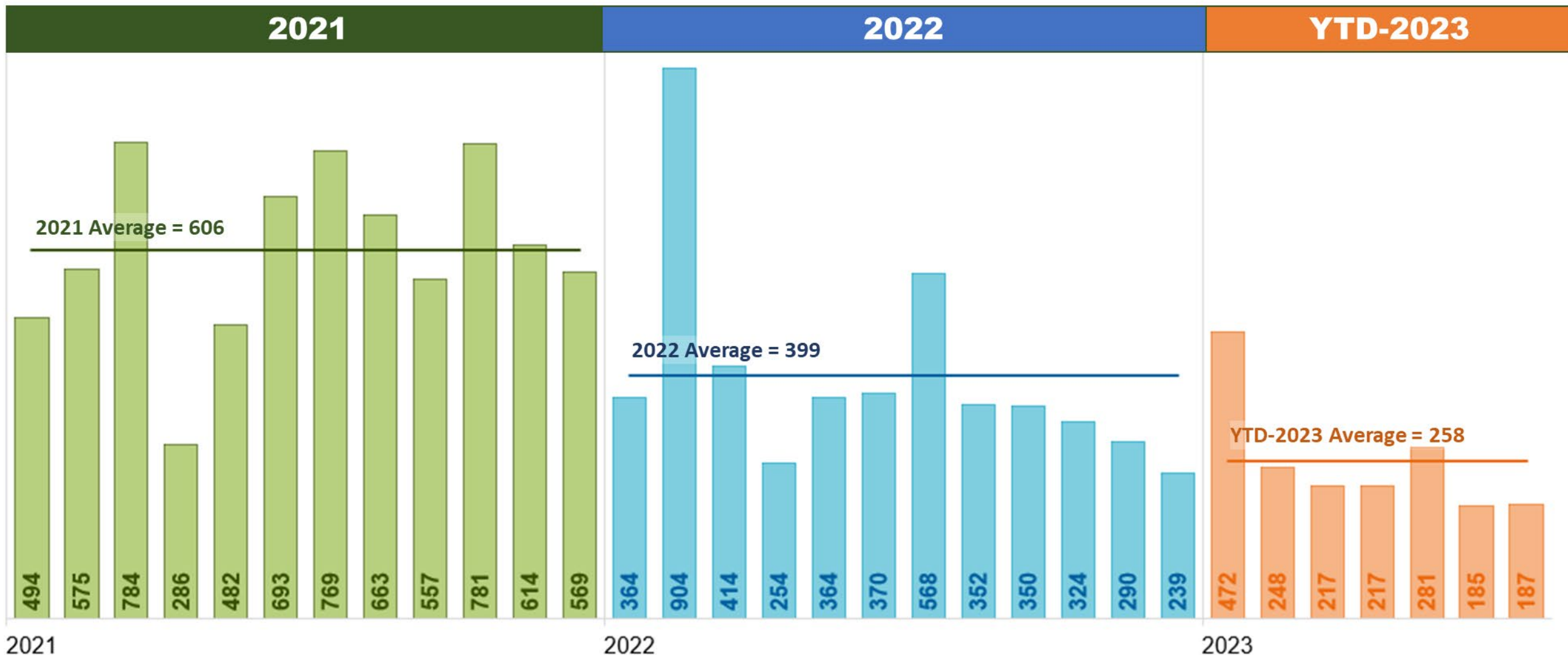
Source: Bureau of Labor Statistics; FRB Atlanta – Center for Real Estate Excellence

Year-Ago Job Growth, June 2023



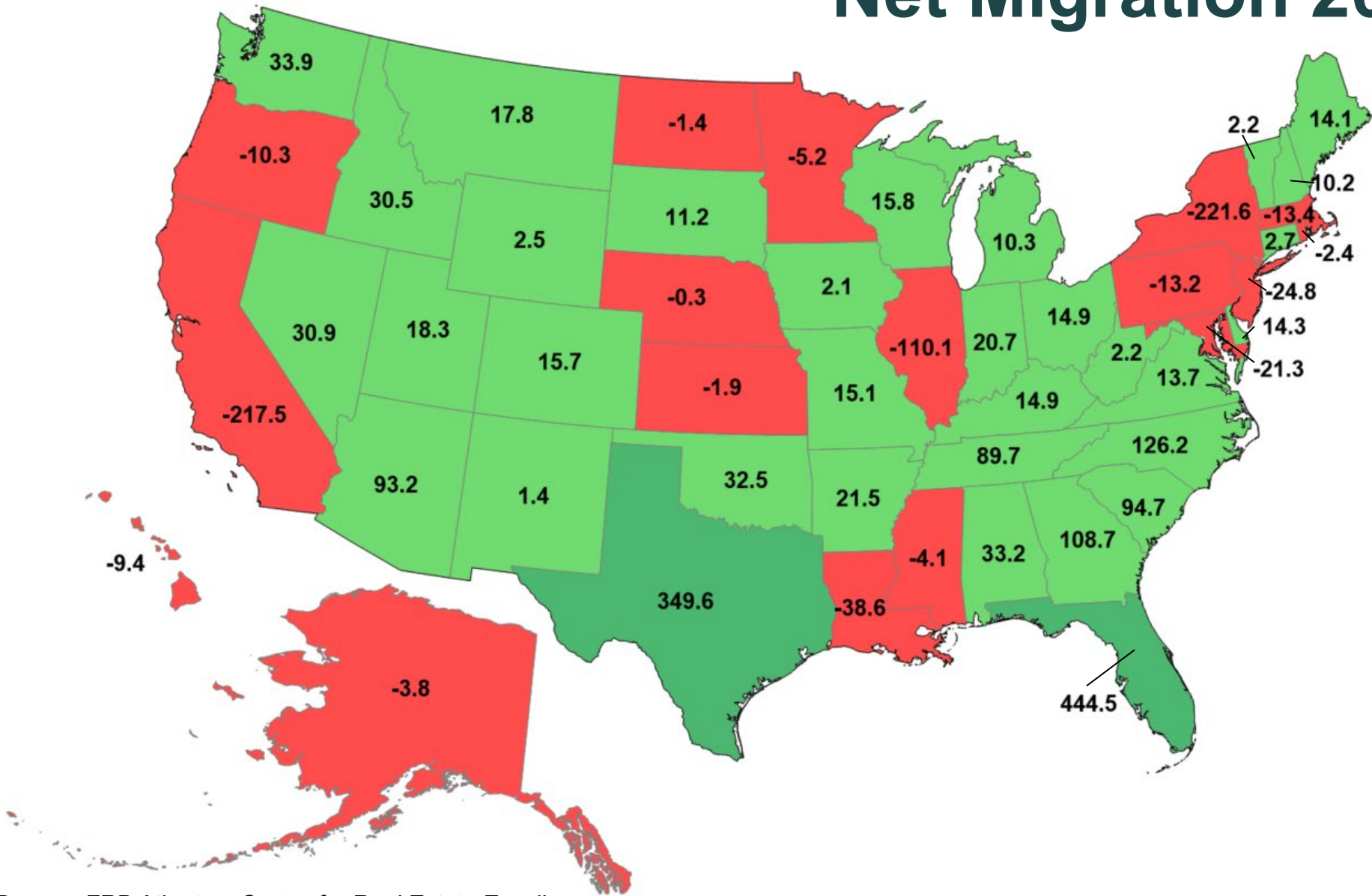
Source: Bureau of Labor Statistics; FRB Atlanta – Center for Real Estate Excellence

U.S. Monthly Employment Change (000s, SA)



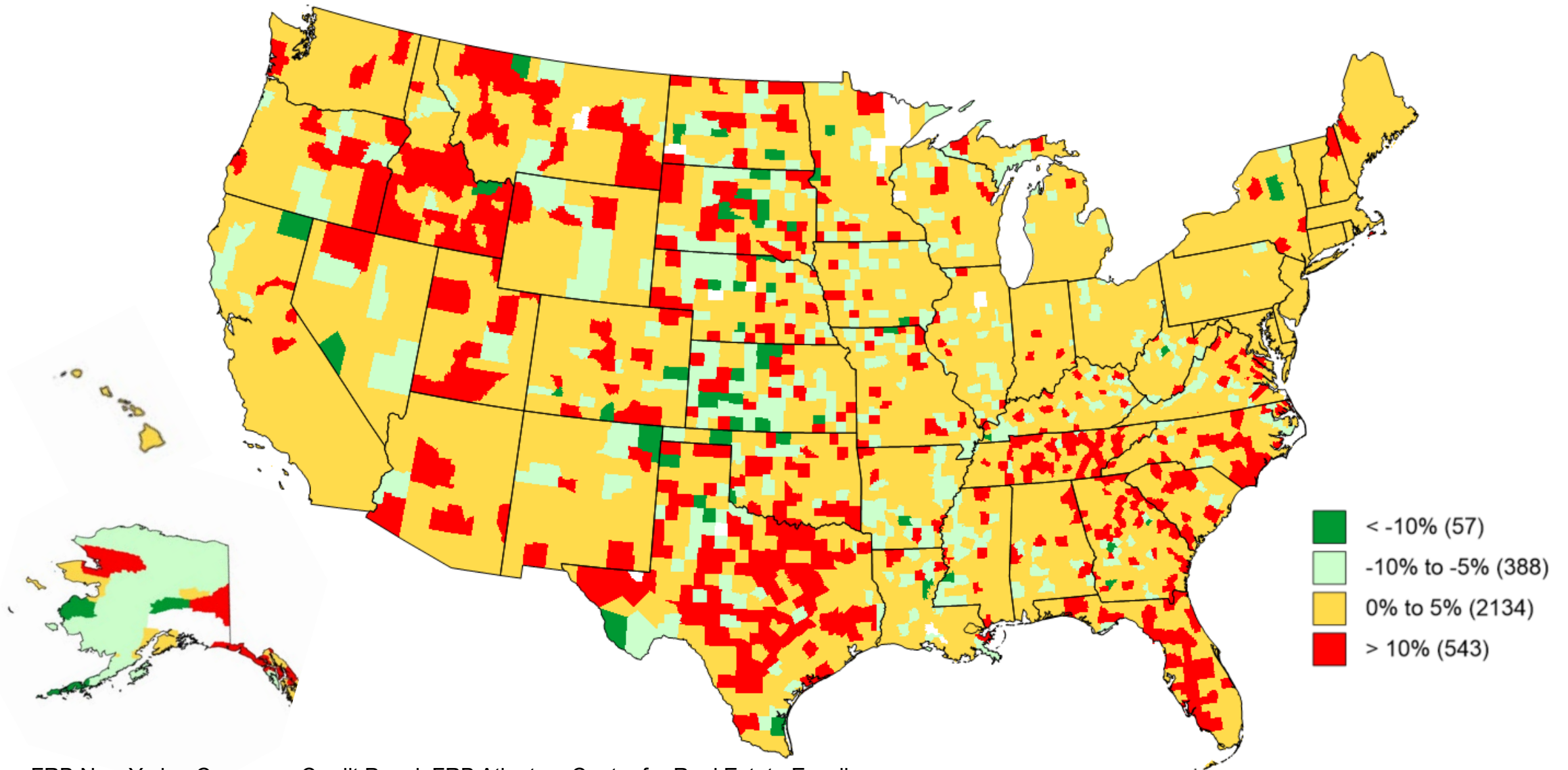
Source: Bureau of Labor Statistics; FRB Atlanta – Center for Real Estate Excellence

Net Migration 2022 (000s)



Source: U.S. Census Bureau; FRB Atlanta – Center for Real Estate Excellence

Consumer Debt Growth (June 2023, YoY%Δ)



Source: FRB New York – Consumer Credit Panel; FRB Atlanta – Center for Real Estate Excellence

Inflation Remains Above Target

(CPI-U [July 2023, YoY%Δ])

	CPI-U	Core	Food & Beverage	Energy	Housing	Shelter	Fuels&Utilities	Household Ops	Home Ownership	Rent	Lodging	Transportation	Medical Care	Education	Communication	Other Goods & Svcs	Gasoline	New Vehicles	Used Vehicles	
2023	Jul	3.3	4.7	4.8	-12.3	6.2	7.7	-0.7	2.9	7.7	8.0	6.1	-2.6	-0.5	3.2	-0.1	6.1	-19.9	3.5	-5.6
	Jun	3.1	4.8	5.7	-16.5	6.3	7.8	-1.1	3.6	7.8	8.3	4.6	-4.7	0.1	3.1	-0.3	6.3	-26.5	4.1	-5.2
	May	4.1	5.3	6.6	-11.3	6.8	8.0	0.9	4.2	8.0	8.7	3.4	-1.7	0.7	3.4	0.1	6.7	-19.7	4.7	-4.2
	Apr	5.0	5.5	7.5	-4.9	7.4	8.1	4.8	5.3	8.1	8.8	3.3	0.3	1.1	3.6	0.1	6.6	-12.2	5.4	-6.6
	Mar	5.0	5.6	8.2	-6.4	7.8	8.2	7.3	5.6	8.0	8.8	7.3	-0.9	1.5	3.5	-0.2	6.1	-17.4	6.1	-11.2
	Feb	6.0	5.5	9.2	5.0	8.2	8.1	11.1	6.1	8.0	8.8	6.7	2.4	2.3	3.3	-0.6	6.1	-2.0	5.8	-13.6
	Jan	6.3	5.6	9.9	8.4	8.3	7.9	13.2	5.9	7.8	8.6	7.7	3.6	3.1	3.4	-0.7	6.2	1.5	5.8	-11.6
2022	Dec	6.4	5.7	10.2	7.1	8.1	7.5	13.5	6.7	7.5	8.3	2.9	3.7	4.0	3.3	-1.1	6.4	-1.2	5.9	-8.8
	Nov	7.1	6.0	10.3	13.1	7.8	7.1	13.2	7.6	7.1	7.9	2.9	7.9	4.2	3.1	-1.1	7.0	10.3	7.2	-3.3
	Oct	7.8	6.3	10.6	17.7	7.9	6.9	14.2	8.4	6.9	7.5	5.7	11.2	5.0	3.0	-2.2	6.5	17.6	8.4	2.0
	Sep	8.2	6.6	10.8	19.9	8.0	6.6	16.9	9.3	6.7	7.2	3.2	12.6	6.0	3.1	-1.9	6.9	18.5	9.4	7.2
	Aug	8.2	6.3	10.9	23.8	7.8	6.3	17.2	9.8	6.3	6.7	4.2	13.4	5.3	3.1	-1.4	6.6	25.6	10.1	7.8
	Jul	8.4	5.9	10.4	32.5	7.4	5.7	16.6	10.1	5.8	6.3	1.2	16.1	4.8	2.6	-1.0	6.3	43.2	10.4	6.6
	Jun	8.9	5.9	10.0	41.3	7.3	5.6	17.7	9.5	5.5	5.8	9.9	19.5	4.5	2.7	-0.6	6.7	59.6	11.4	7.1
2021	May	8.5	6.0	9.7	34.2	6.9	5.4	15.5	8.9	5.1	5.2	19.3	19.2	3.7	2.5	-0.5	6.3	48.4	12.6	16.1
	Apr	8.2	6.2	9.0	30.2	6.5	5.1	13.0	9.9	4.8	4.8	19.7	19.9	3.2	2.5	-0.1	5.7	43.6	13.2	22.7
	Mar	8.5	6.5	8.5	31.6	6.4	5.0	12.5	10.2	4.5	4.4	25.3	22.3	2.9	2.5	0.8	5.5	47.3	12.5	35.3
	Feb	8.0	6.4	7.6	26.0	6.0	4.8	11.1	9.7	4.3	4.2	25.2	21.2	2.4	2.1	1.1	5.6	38.4	12.4	41.2
	Jan	7.6	6.0	6.7	27.5	5.7	4.4	11.9	9.0	4.1	3.8	20.6	21.1	2.5	2.1	1.2	4.9	40.8	12.2	40.5
	Dec	7.2	5.5	6.0	30.0	5.1	4.2	9.5	7.4	3.8	3.3	24.0	21.7	2.2	2.0	1.3	4.5	50.1	11.8	37.3
	Nov	6.9	4.9	5.8	33.3	4.8	3.9	10.0	6.5	3.5	3.0	22.2	21.2	1.8	2.1	1.3	4.4	58.0	11.1	31.4
2020	Oct	6.2	4.6	5.1	29.9	4.5	3.5	10.4	6.2	3.1	2.7	22.3	18.7	1.3	2.1	1.5	4.2	49.7	9.8	26.4
	Sep	5.4	4.0	4.4	25.0	3.9	3.2	8.2	5.1	2.9	2.4	17.8	16.6	0.4	1.9	1.5	3.4	42.2	8.7	24.4
	Aug	5.2	4.0	3.6	25.0	3.5	2.8	7.9	4.0	2.5	2.1	17.3	17.6	0.3	1.4	1.1	3.5	42.7	7.6	31.9
	Jul	5.2	4.3	3.3	23.4	3.3	2.8	7.1	3.8	2.4	1.9	21.3	18.8	0.3	1.2	1.1	2.9	41.3	6.4	41.7
	Jun	5.3	4.5	2.3	24.2	3.1	2.6	6.5	4.1	2.3	1.9	14.8	21.1	0.4	1.1	2.8	2.5	45.0	5.3	45.2
	May	4.9	3.8	2.1	27.7	2.9	2.2	6.4	4.6	2.1	1.8	9.1	19.6	0.9	1.0	2.6	2.7	55.9	3.3	29.7
	Apr	4.1	3.0	2.3	24.8	2.6	2.1	5.6	3.5	2.0	1.8	7.2	14.7	1.5	0.8	2.4	2.7	49.4	2.0	21.0
	Mar	2.6	1.6	3.4	13.0	2.1	1.7	4.4	3.2	2.0	1.8	-6.4	5.9	1.8	0.8	2.1	2.4	22.1	1.5	9.4
	Feb	1.7	1.3	3.5	2.5	1.8	1.5	3.5	2.7	2.0	2.0	-14.8	0.7	2.0	1.2	2.2	2.1	1.7	1.2	9.3
	Jan	1.4	1.4	3.7	-3.6	1.8	1.6	2.1	2.9	2.0	2.1	-11.5	-1.2	2.0	1.3	2.1	2.1	-8.3	1.4	10.0

Source: Bureau of Labor Statistics; FRB Atlanta – Center for Real Estate Excellence

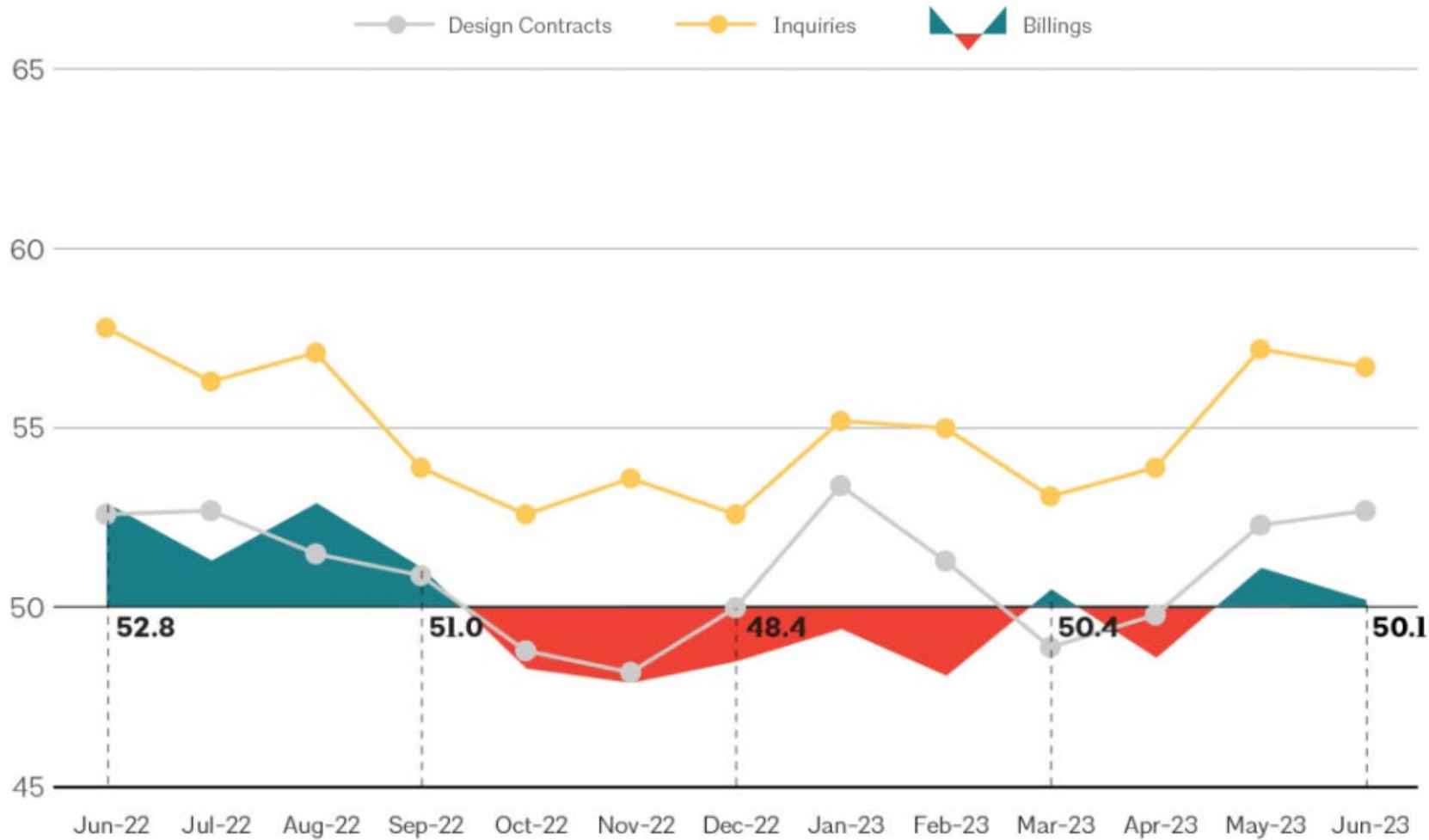
Services Inflation: Still Running Hot?

July 2023

Service	Year-Over-Year $\Delta\%$
Food at Employee Sites & Cafeterias	84.4%
Vending Machines & Mobile Vendors	14.0%
Motor Vehicle Repair	19.5%
Motor Vehicle Insurance	17.8%
Leased Cars and Trucks	10.8%
Tax Return & Accounting Prep Fees	14.4%
Lesson and Instruction Fees	14.2%
Veterinarian Fees	10.6%
Garbage and Trash Collection	8.8%
Haircuts	5.3%

Source: Wall Street Journal; S&R – Risk Analysis Unit/FRB Atlanta

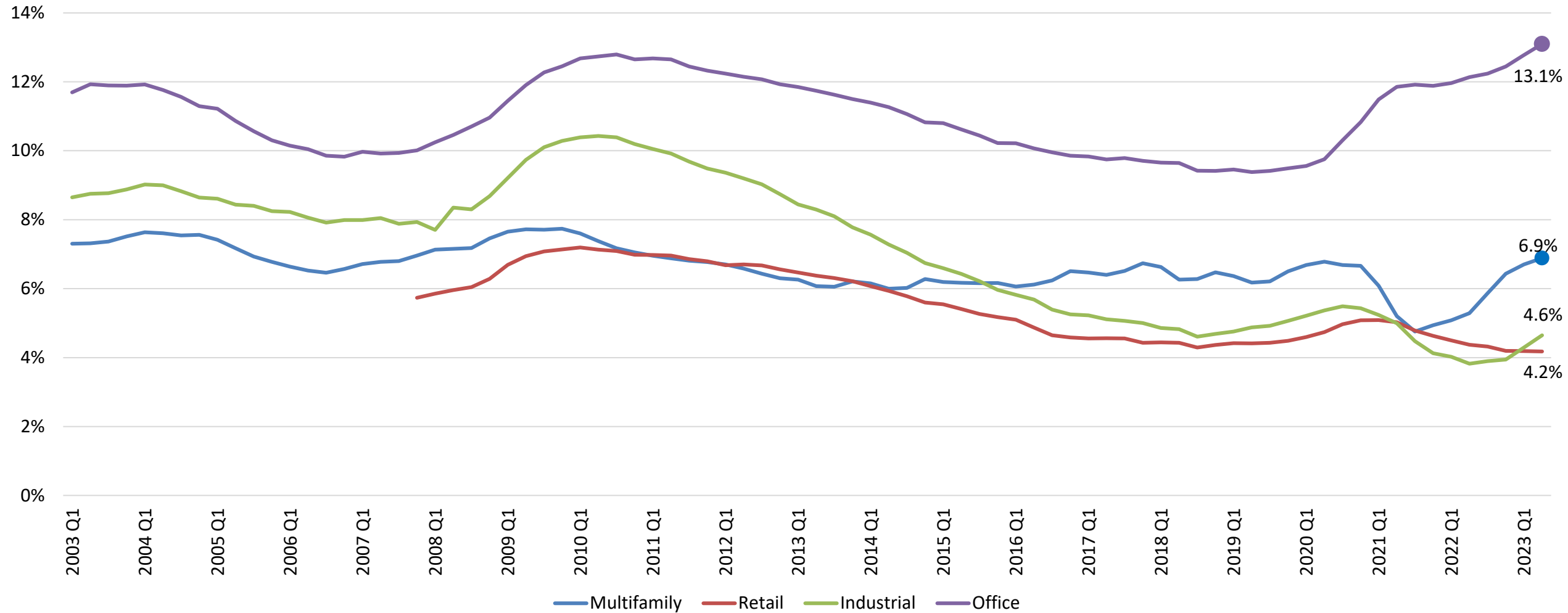
Future CRE Activity, Moving Forward



- The Architecture Billings Index is an economic indicator for nonresidential construction activity.
- A result below 50 indicates activity is contracting, while above 50 represents an expansion.

Source: Architectural Billings Index; FRB Atlanta – Center for Real Estate Excellence

National Vacancy Rates 2023Q2



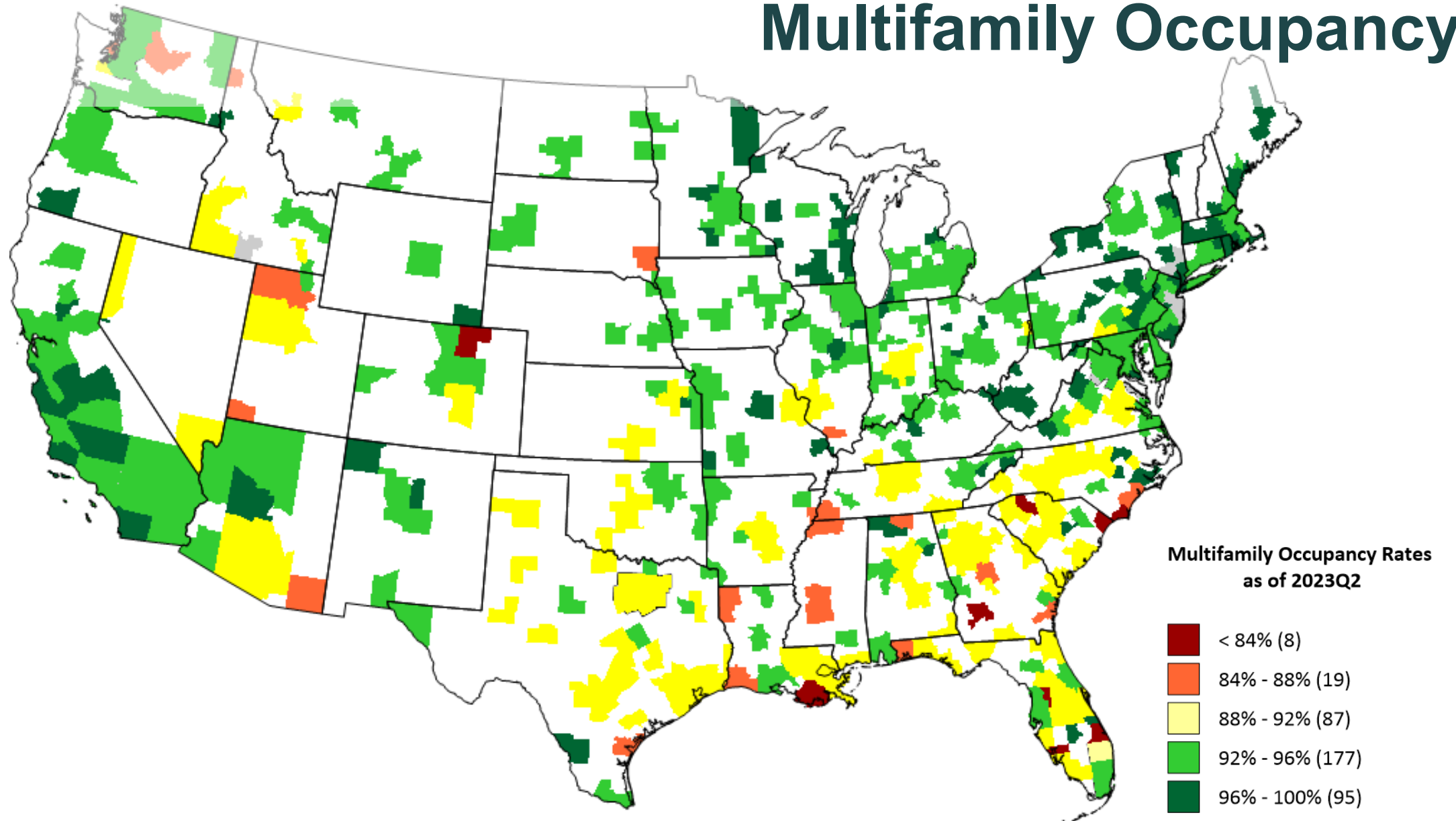
Date: 2001 Q1 – 2023 Q2

Source: CoStar; FRB Atlanta – Center for Real Estate Excellence

Multifamily

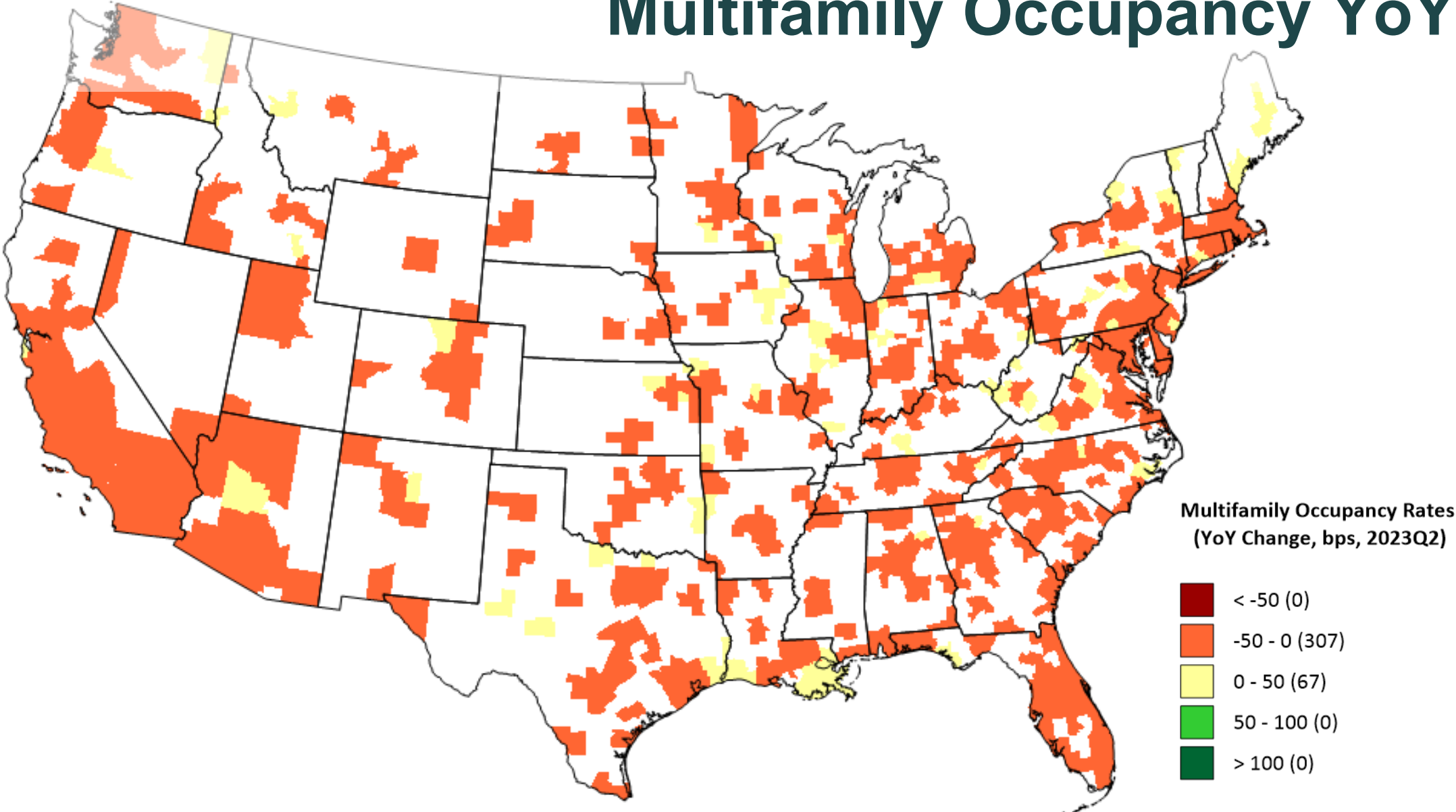


Multifamily Occupancy



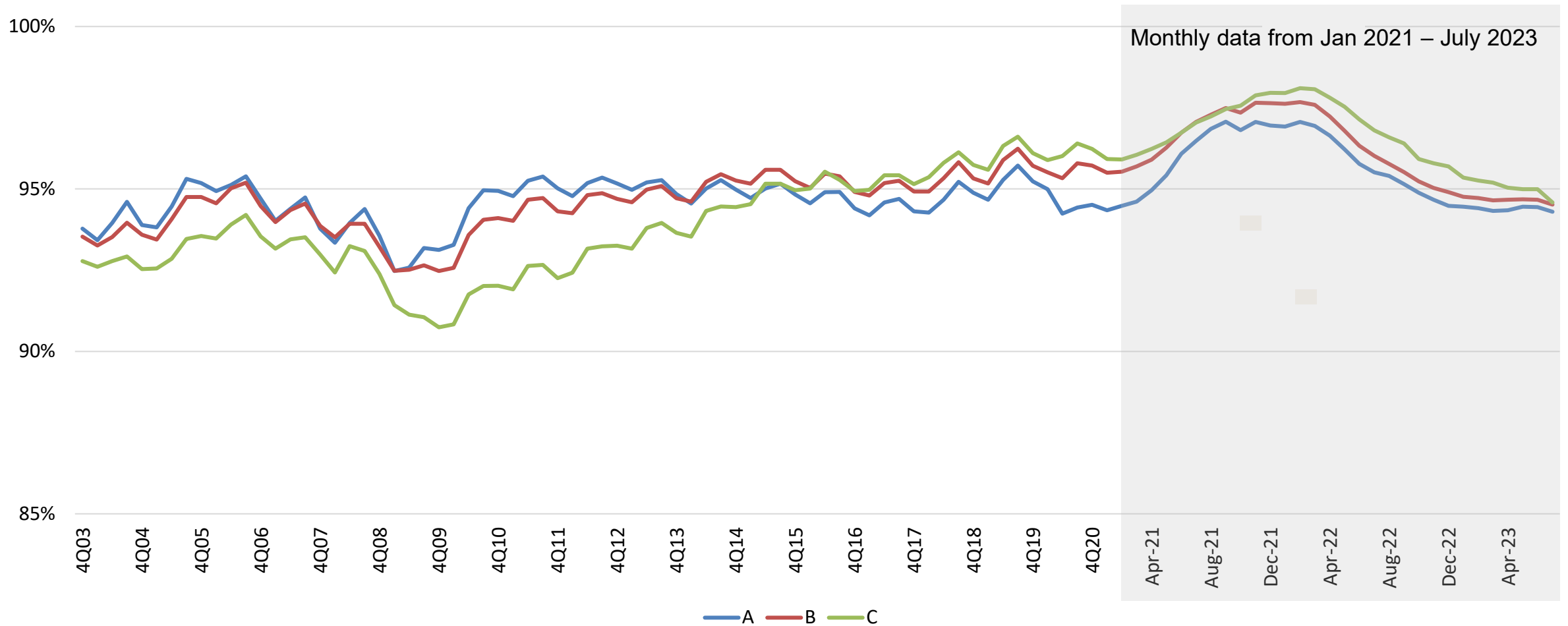
Source: CoStar; FRB Atlanta – Center for Real Estate Excellence

Multifamily Occupancy YoY



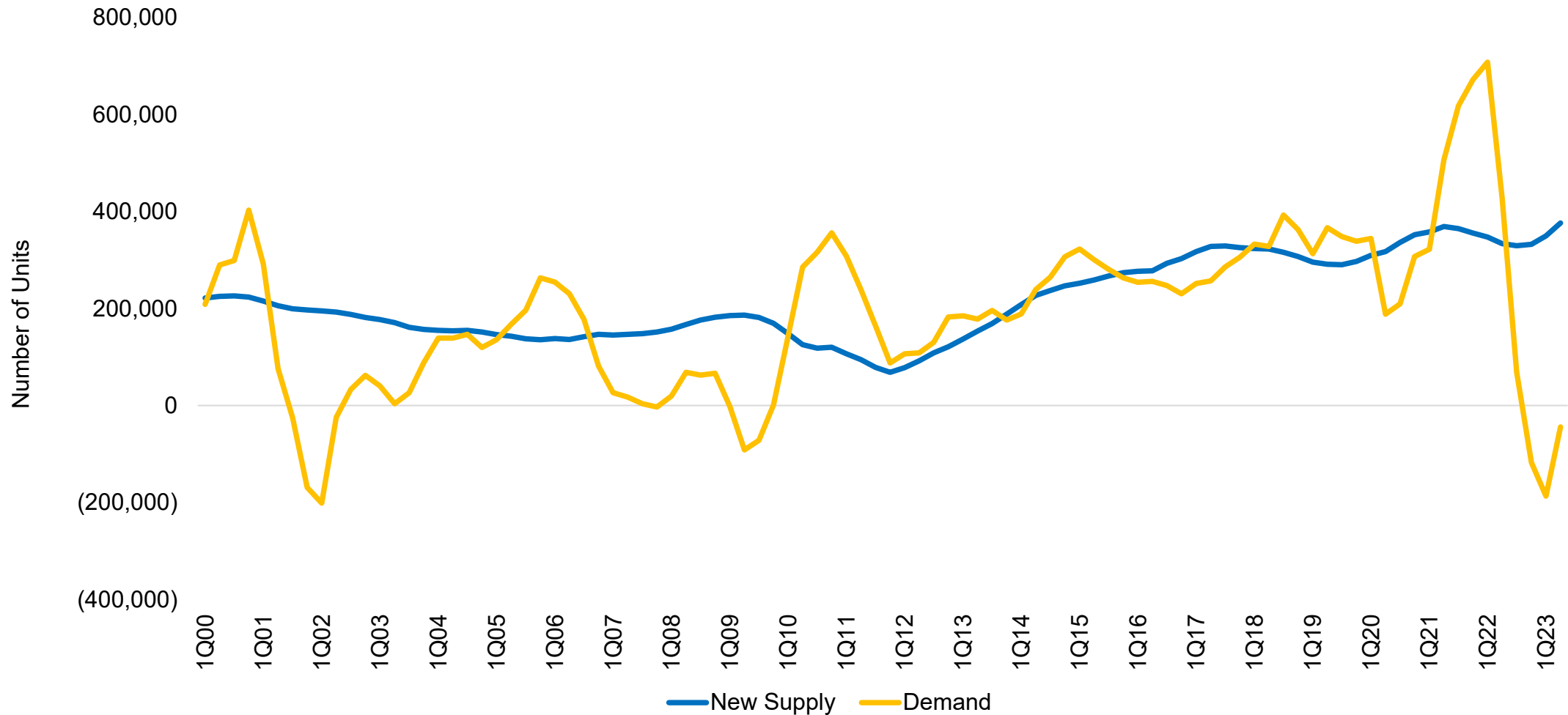
Source: CoStar; FRB Atlanta – Center for Real Estate Excellence

National Multifamily Apartment Occupancy



Source: Real Page; FRB Atlanta – Center for Real Estate Excellence

Declining Multifamily Occupancy



4 Quarter Rolling Sum

Source: RealPage; Risk Analysis Unit/Federal Reserve Bank of Atlanta

Office

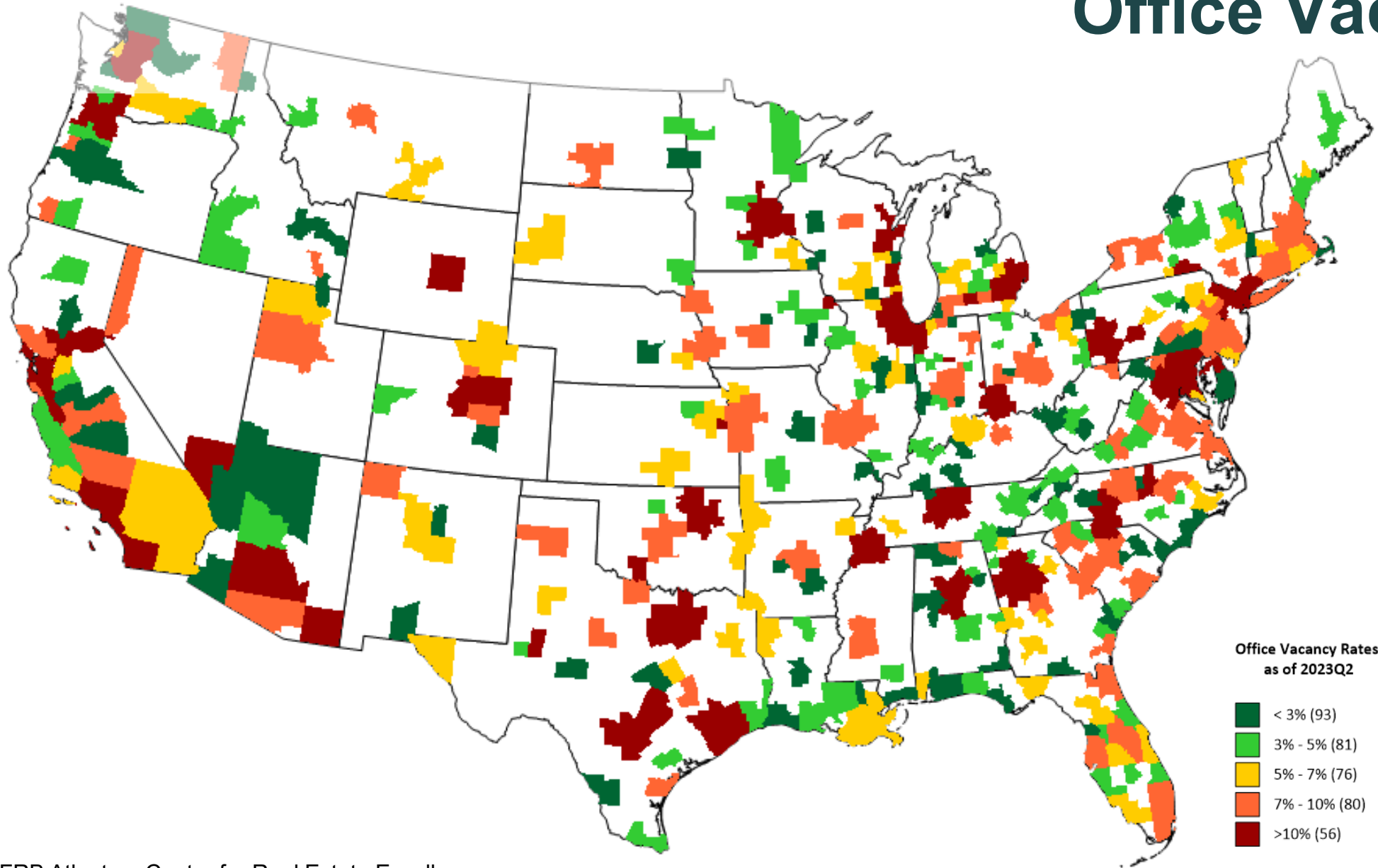


Polling Question #2

How often are the office employees at your firm, in the office?

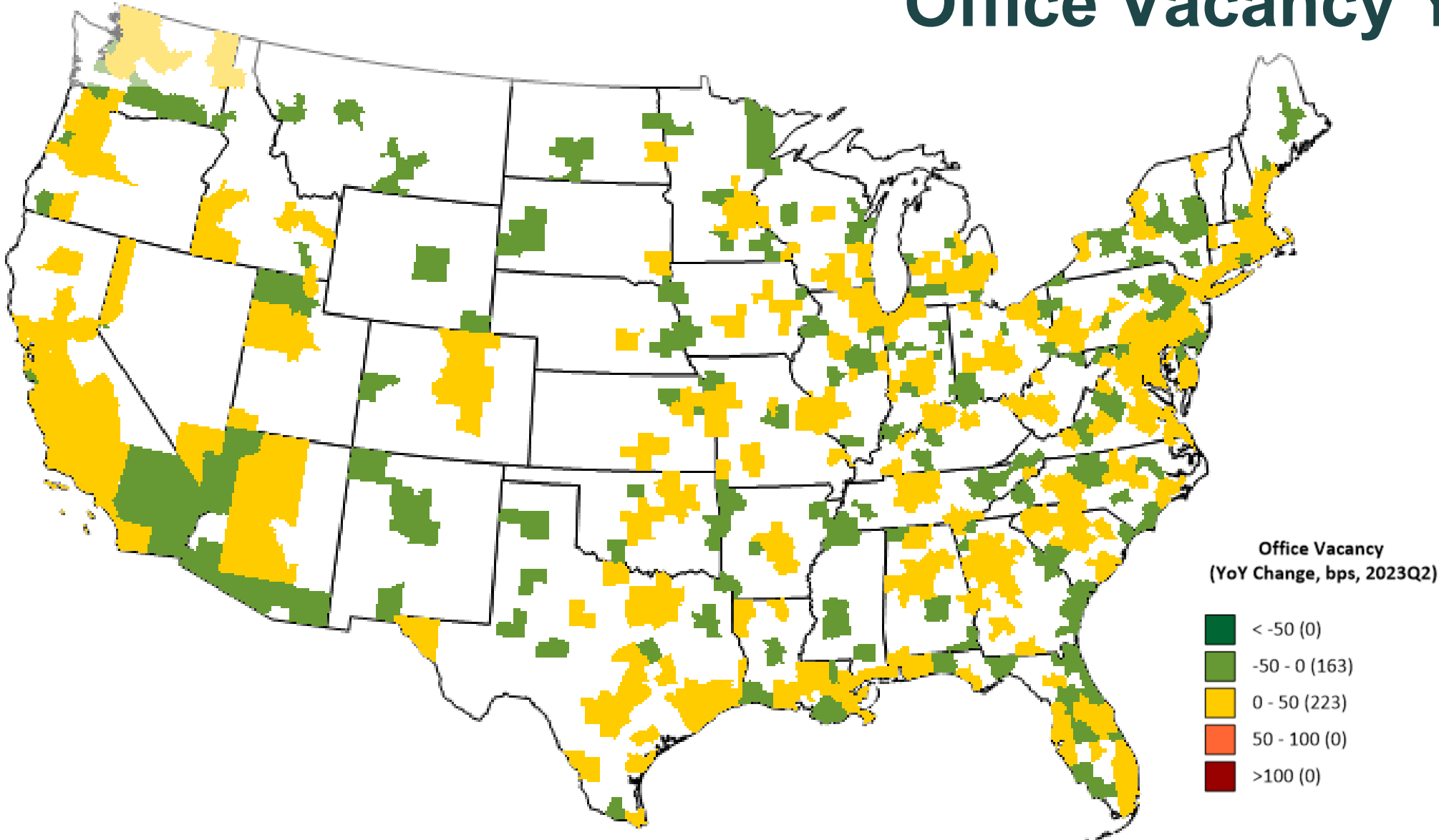
- A. Less than 1 day a week.
- B. 1-2 days a week.
- C. 2-3 days a week.
- D. 3-4 days a week.
- E. More than 4 days a week.

Office Vacancy



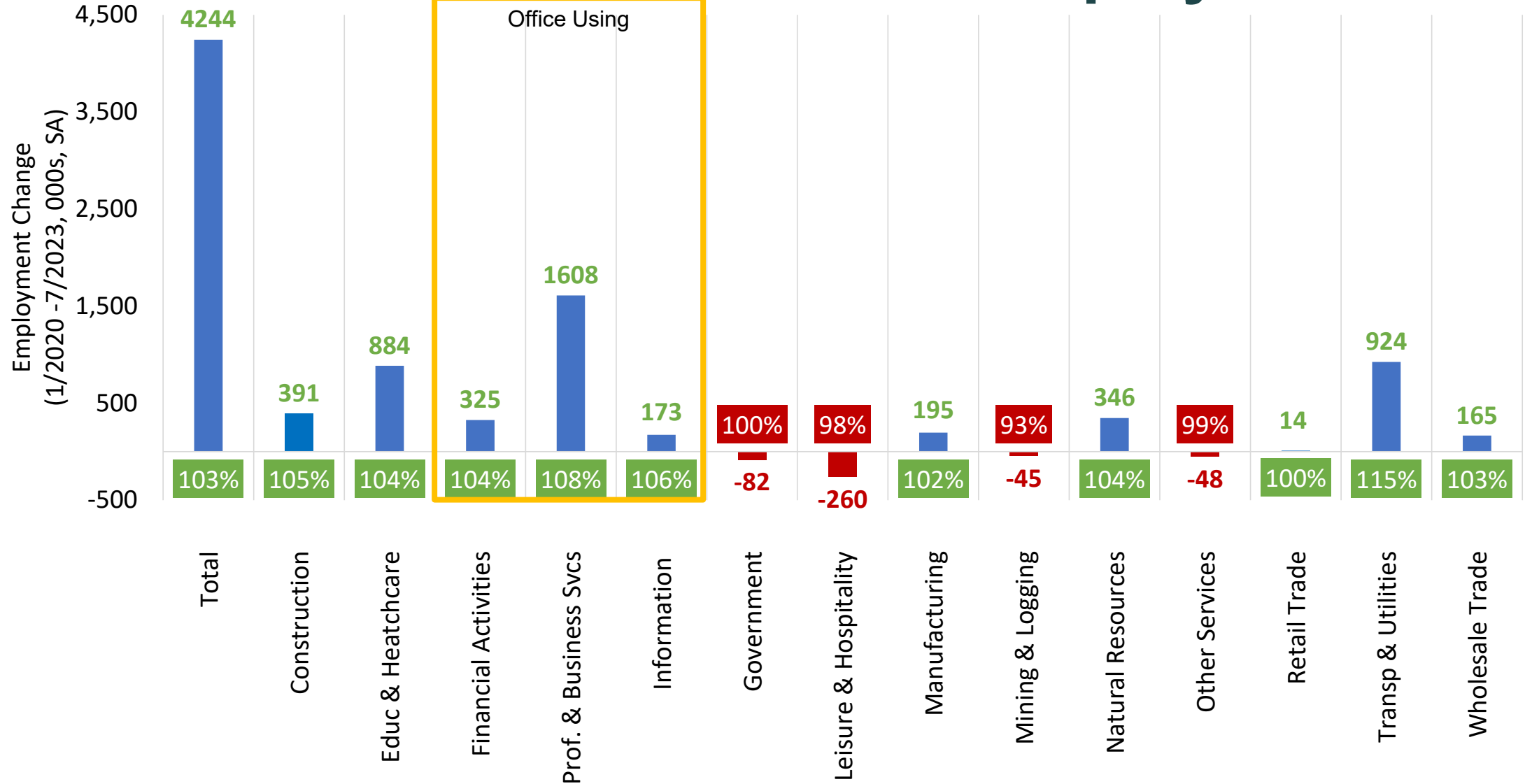
Source: CoStar; FRB Atlanta – Center for Real Estate Excellence

Office Vacancy YoY



Source: CoStar; FRB Atlanta – Center for Real Estate Excellence

U.S. Sector Employment Growth



Source: Bureau of Labor Statistics; FRB Atlanta – Center for Real Estate Excellence

Remote Work

- Remote work has doubled every 15 years going back to the 1960s. The pandemic created a five-fold jump.
- Some industries/businesses will not come back to the office.
- Remote work reduces communication, mentoring, learning, networking, and recognition, which creates multiple deficiencies.
- Productivity:
 - Fully remote workers 10–20 percent less productive (Emmanuel & Harrington (2023); Gibbs, Mengel & Siemroth (2022))
 - Hybrid workers 3–13 percent more productive (Bloom, et.al. (2015); Choudhury (2022); Barrero (2023))

Headwinds Persist

- More businesses are requiring that employees report to the office more frequently.
- Initial reports indicate enhanced performance for those who are on site.
- Most of the office leasing activity is occurring in buildings that have been significantly renovated and/or are newer than approximately 2012.
- Newly constructed office space will create more pressure on existing space, and landlords of older buildings will have a more challenging time raising rents.
- For the next several years, lease rollover will create headwinds as existing users use the opportunity to right-size their footprint. Sizeable amounts of sublease space will have to be removed from the market before there is consistent traction.
- Functional obsolescence will accelerate.

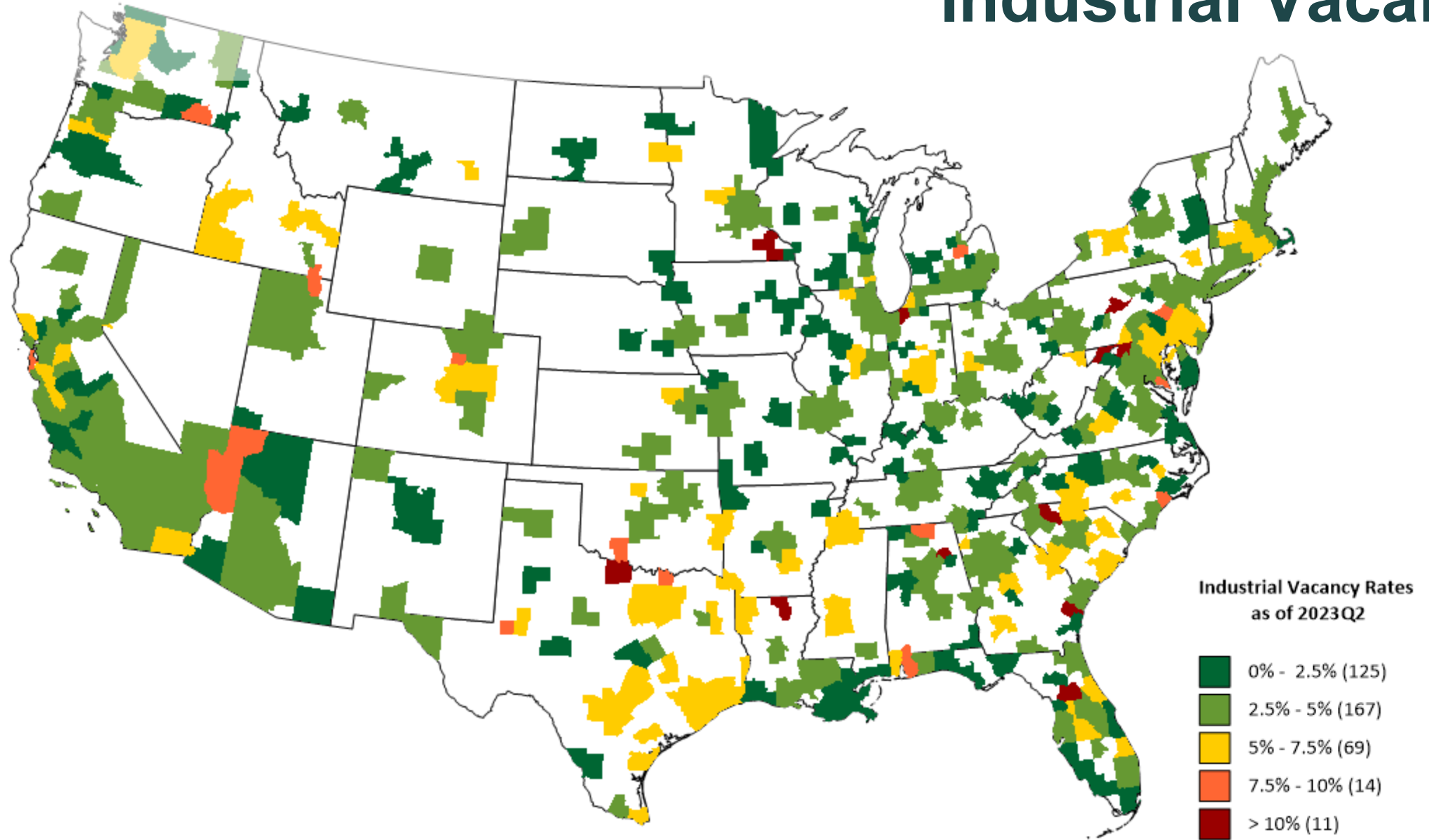
Source: Risk Analysis Unit/Federal Reserve Bank of Atlanta



Industrial

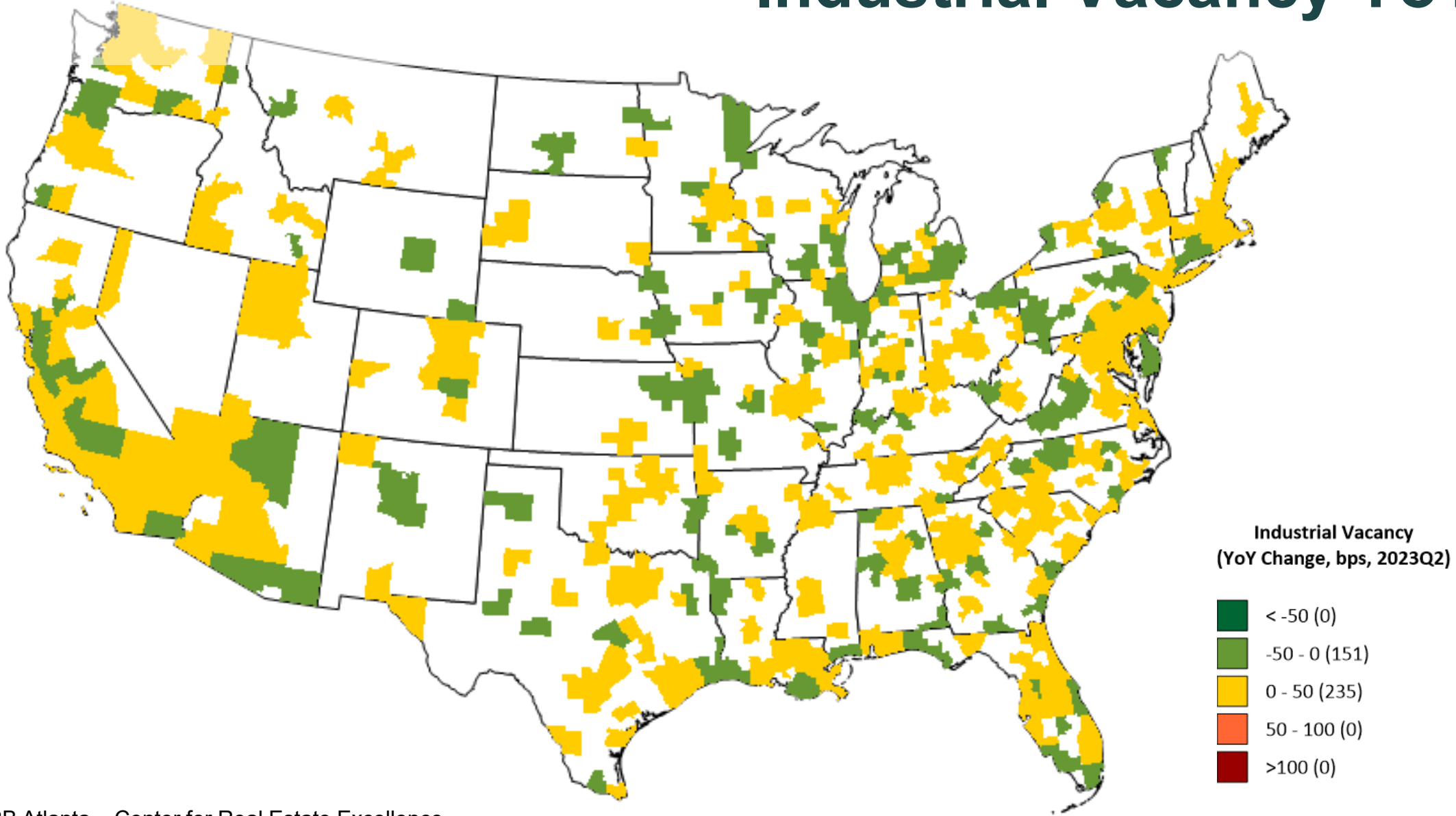


Industrial Vacancy



Source: CoStar; FRB Atlanta – Center for Real Estate Excellence

Industrial Vacancy YoY

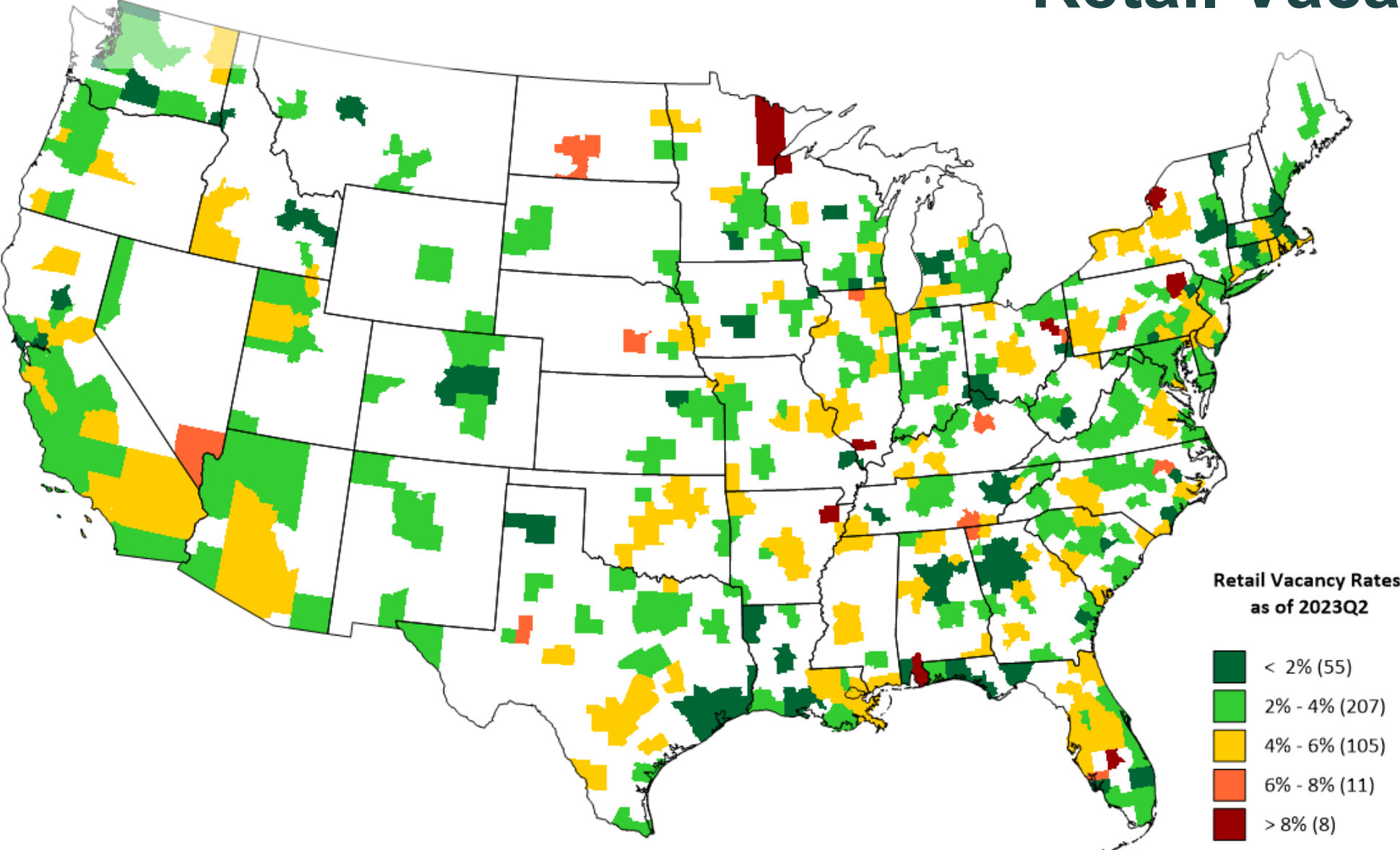


Source: CoStar; FRB Atlanta – Center for Real Estate Excellence

Retail

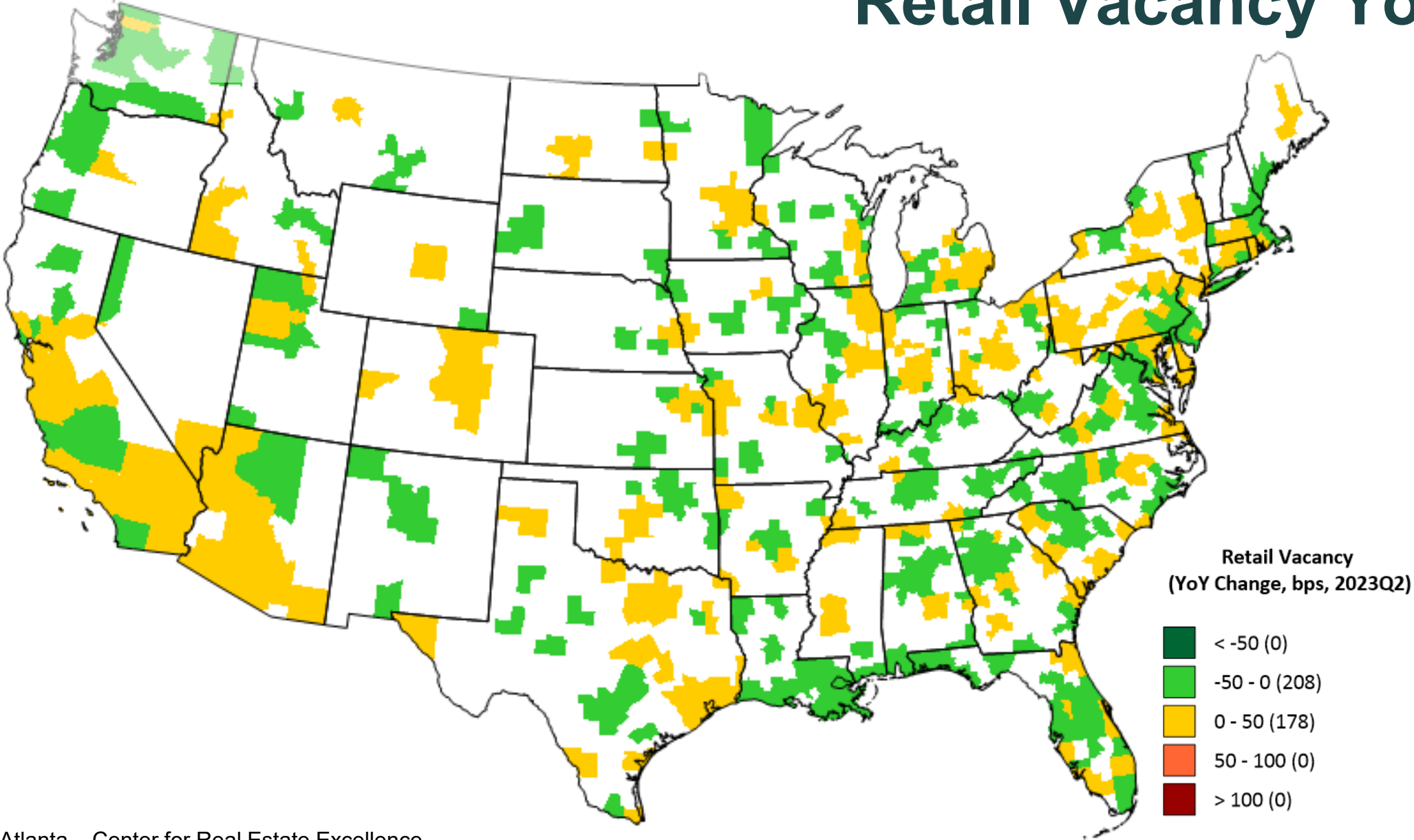


Retail Vacancy



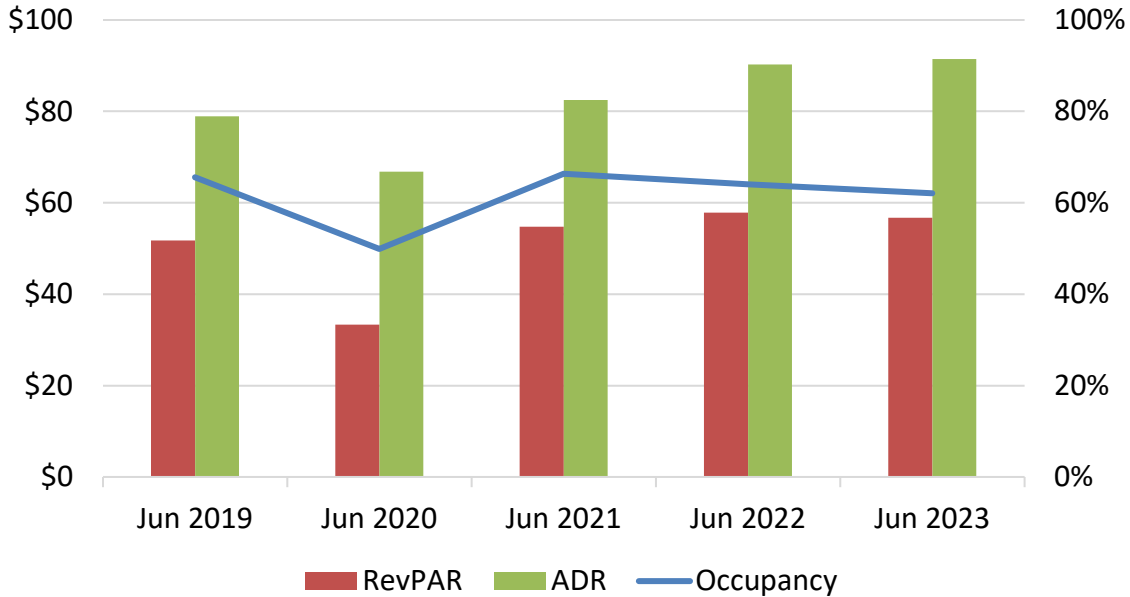
Source: CoStar; FRB Atlanta – Center for Real Estate Excellence

Retail Vacancy YoY

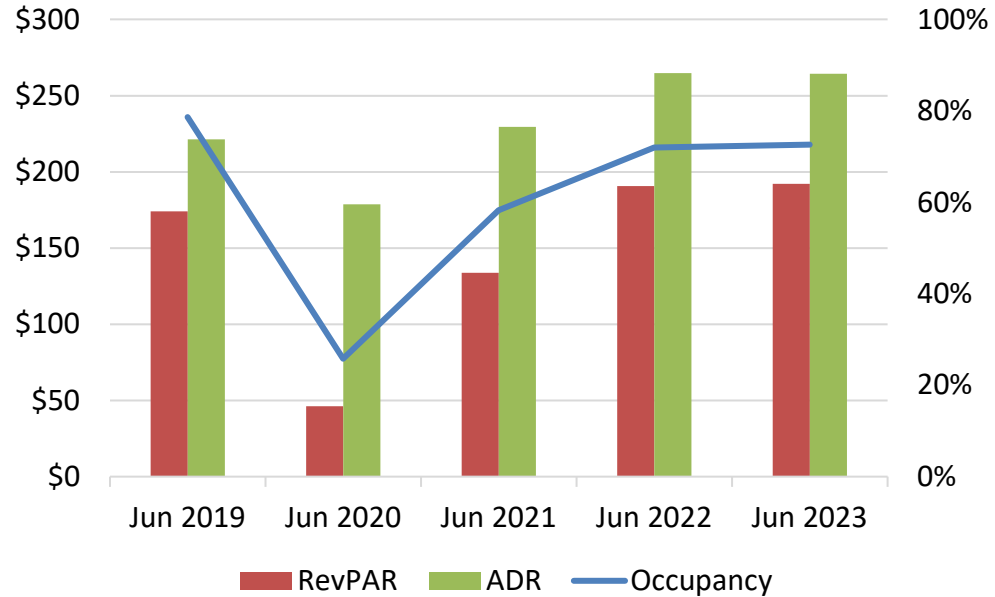


Source: CoStar; FRB Atlanta – Center for Real Estate Excellence

National Hotel Occupancy



Midscale/Economy



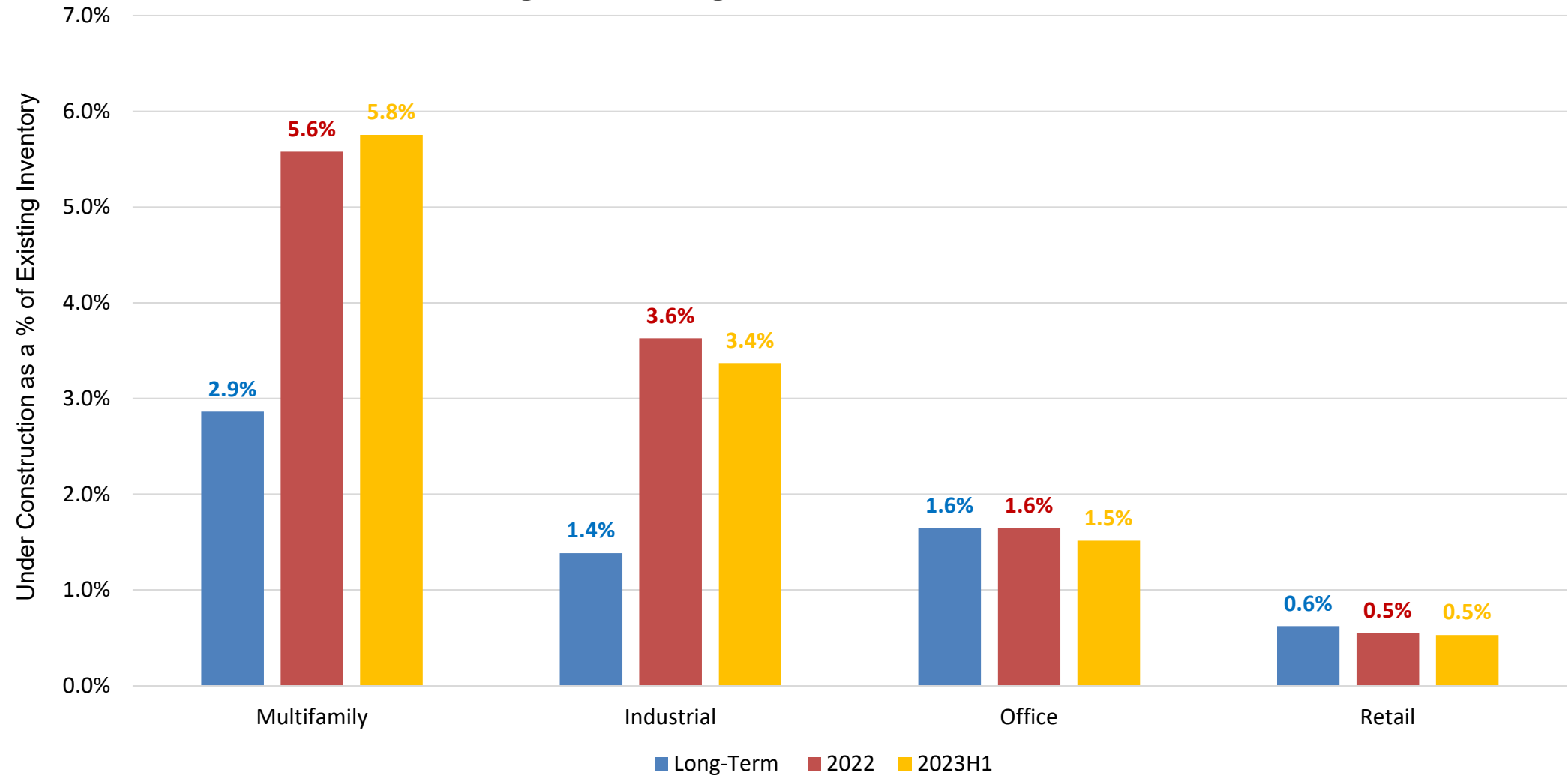
Luxury/Upscale

- ADR: average daily rate
- RevPAR: revenue per available room

Source: CoStar; FRB Atlanta – Center for Real Estate Excellence

National Construction

Long-Term Avg / 2022 / 2023H1



Source: CoStar; FRB Atlanta – Center for Real Estate Excellence

Polling Question #3

What amount of CRE loans will need to be refinanced in the next five years?

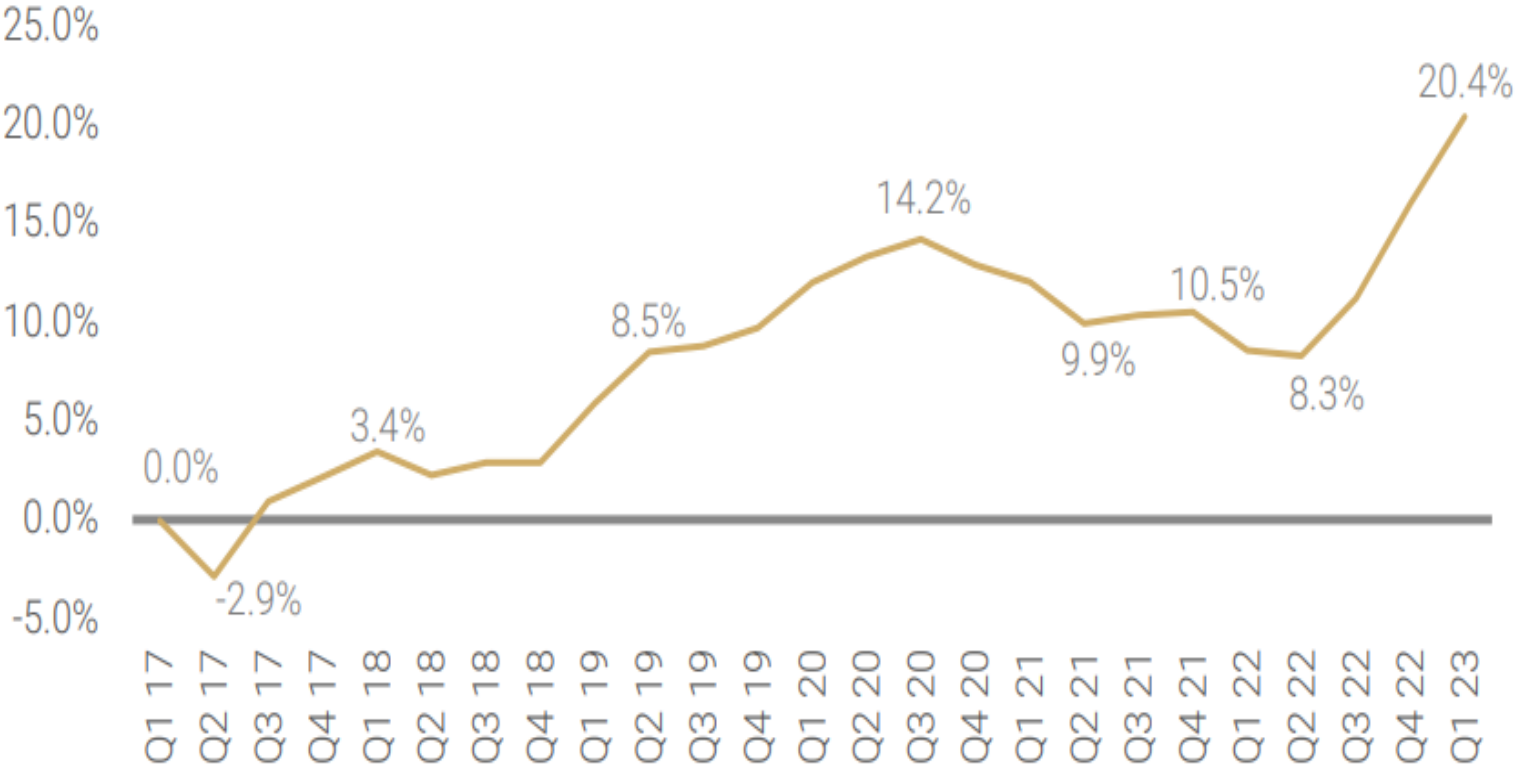
- A. Approximately \$1 trillion
- B. Approximately \$2 trillion
- C. Approximately \$3 trillion
- D. Approximately \$4 trillion
- E. No idea

CRE: Areas of Heightened Concern

- **Inability of market participants to accurately assess CRE asset value:**
 - The bid/ask spread has widened significantly, causing transaction volume to falter.
 - Net operating income (NOI) growth has moderated and, in some instances, turned negative.
 - Cap rates are rising.
- **Consumer-related real estate:**
 - Inflation is creating sizeable challenges for consumers as they spend more for basic needs.
- **Luxury apartments:**
 - A significant number of units are under construction, while occupancy is declining, and concessions are increasing.
- **Office:**
 - Changes in the utilization and demand for office space
- **Finance:**
 - Roughly \$2 trillion of CRE loans need to be refinanced in the next five years.
 - The increasing cost of debt and rate caps are slowing lending activity and, in some cases, influencing activity to shorter-duration loans.

Commercial Insurance

Premium Change for Commercial Property, Q1 2017 - Q1 2023



Commercial property insurance premiums changing at fastest rate in the last decade.

- Q1 2023 +20.4%.
- Q4 2013–Q4 2016 Avg.+3.5%/Q.
- Low: -13.3% (Q3 2007)
- High: 28.5% (Q4 2001)

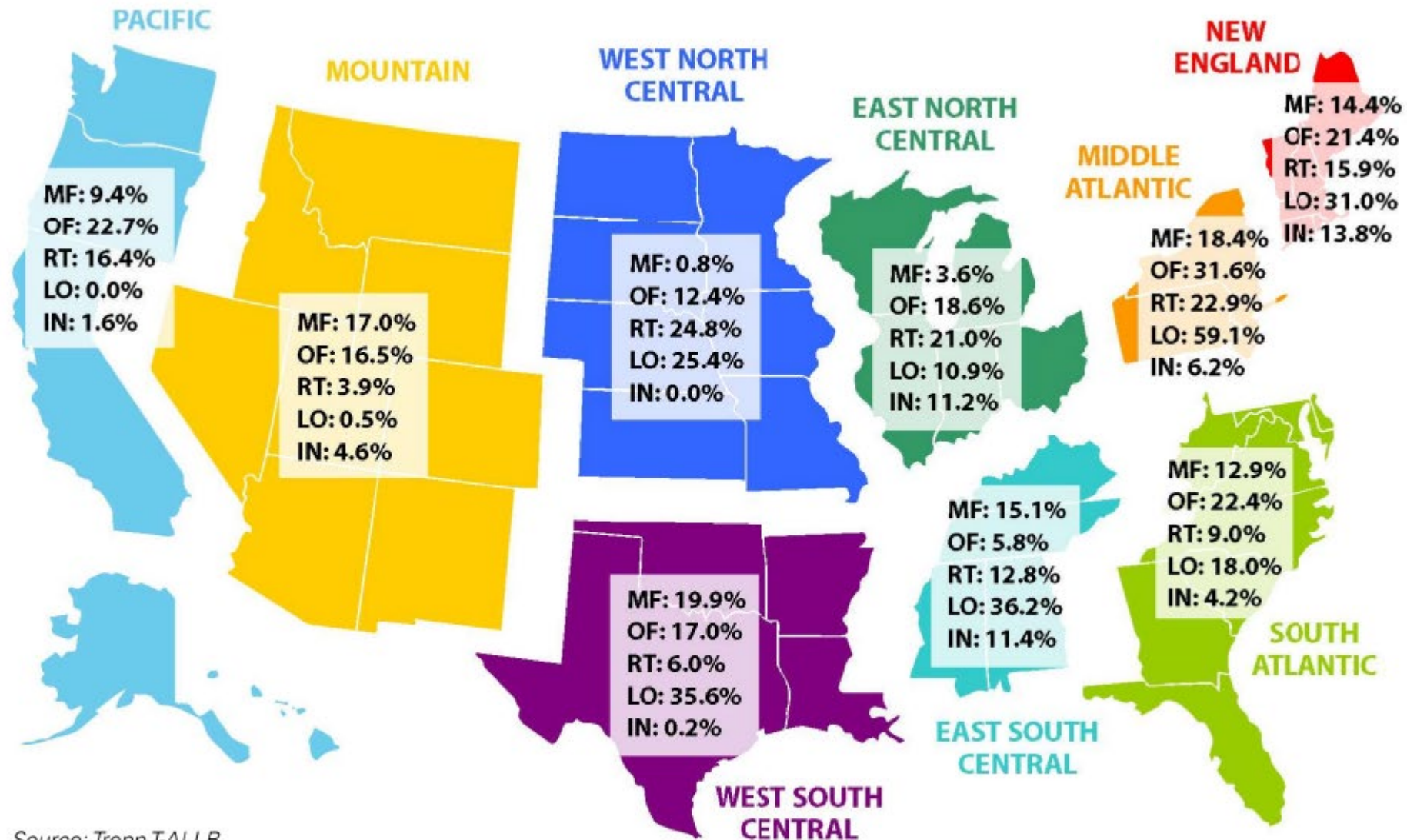
How will increased losses impact?

- Underwriting
- Coverage
- Premiums (e.g., Climate and Crime)
- Accessibility

Source: Council of Insurance Agents & Brokers; FRB Atlanta – Center for Real Estate Excellence

Criticized Loans by Region

2023 Q1

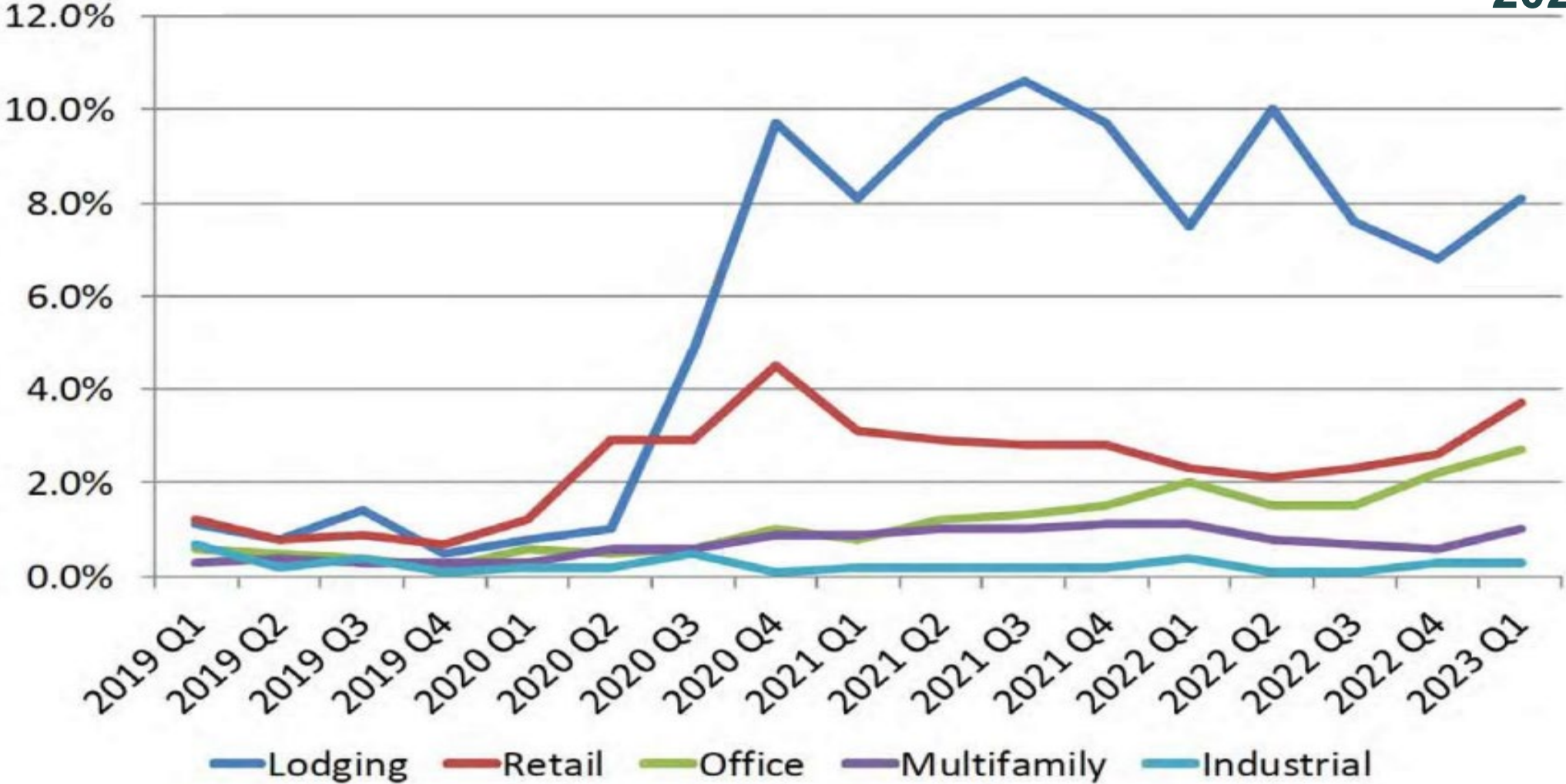


Source: Trepp T-ALLR

- MF: Multifamily
- OF: Office
- RT: Retail
- LO: Lodging
- IN: Industrial

Delinquency Rate By Property Type

2023 Q1



Source: Trepp T-ALLR; FRB Atlanta – Center for Real Estate Excellence

Commercial Mortgage Maturities (\$billions)



Source: MSCI-Real Capital Analytics; S&R – Center for Real Estate Excellence



Jerome Powell

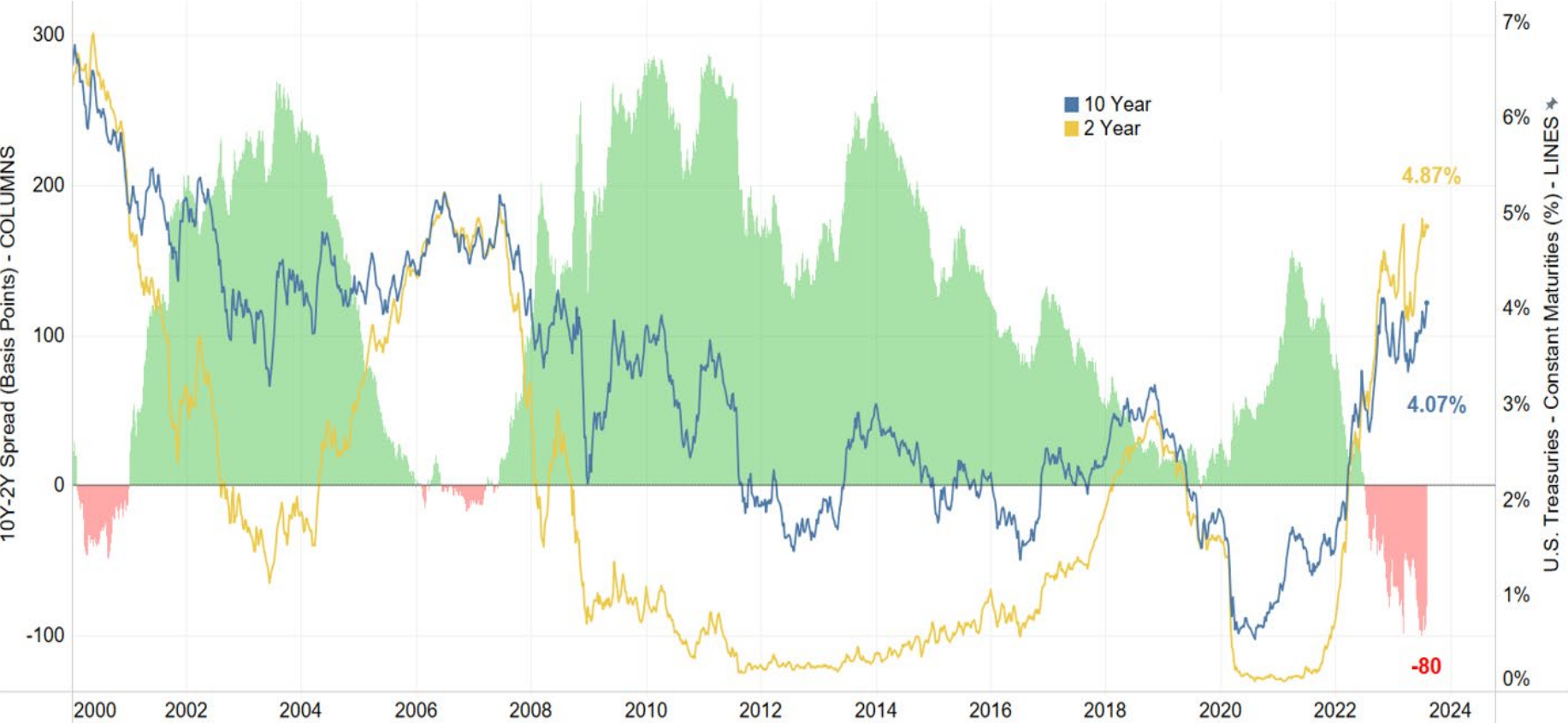
Chair, Federal Reserve Board

“We remain committed to bringing inflation back to our 2 percent goal and to keeping longer-term inflation expectations well anchored. Reducing inflation is likely to require a period of below-trend growth and some softening of labor market conditions. Restoring price stability is essential to set the stage for achieving maximum employment and stable prices over the longer run.

FOMC Press Conference - July 26, 2023

Spreads: 10Yr Treasury/2Yr Treasury

Increased spreads signal greater uncertainty



- Fed Funds Target: 525–550 bps (8/23)
- Long-term rates are beginning to move higher; however, there appears to remain a disconnect between yields and expected economic activity.

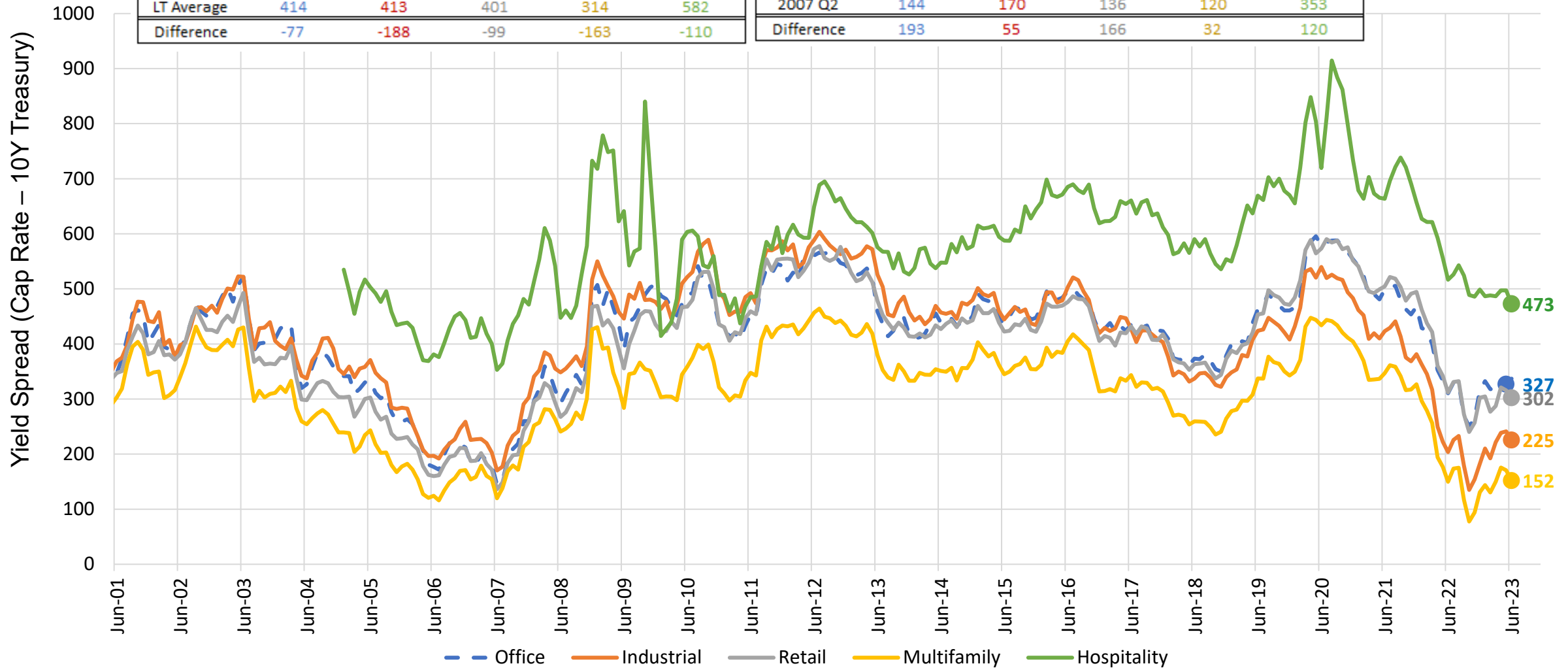
Source: Federal Reserve

National Cap Rates by Property Type

Cap Rates Less Ten-Years Treasury Yields

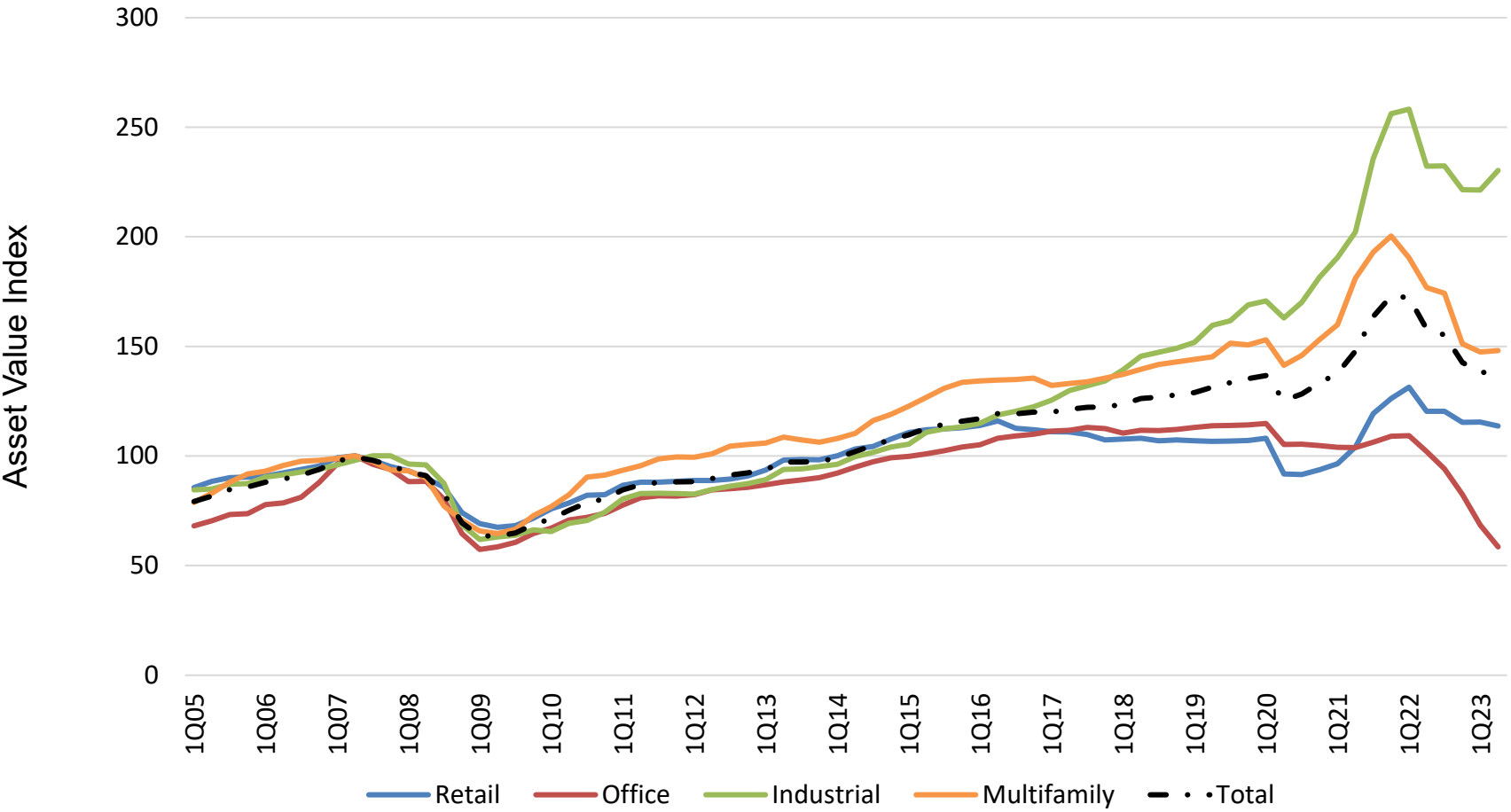
Average	Office	Industrial	Retail	Multifamily	Hospitality
Current	337	225	302	152	473
LT Average	414	413	401	314	582
Difference	-77	-188	-99	-163	-110

Average	Office	Industrial	Retail	Multifamily	Hospitality
Current	337	225	302	152	473
2007 Q2	144	170	136	120	353
Difference	193	55	166	32	120



Source: MSCI/RCA; FRB Atlanta – Center for Real Estate Excellence

Declining Asset Value – National



Core sector: down 20 percent from the peak

Some markets and asset segments will fare better.

Greater headwinds are materializing as:

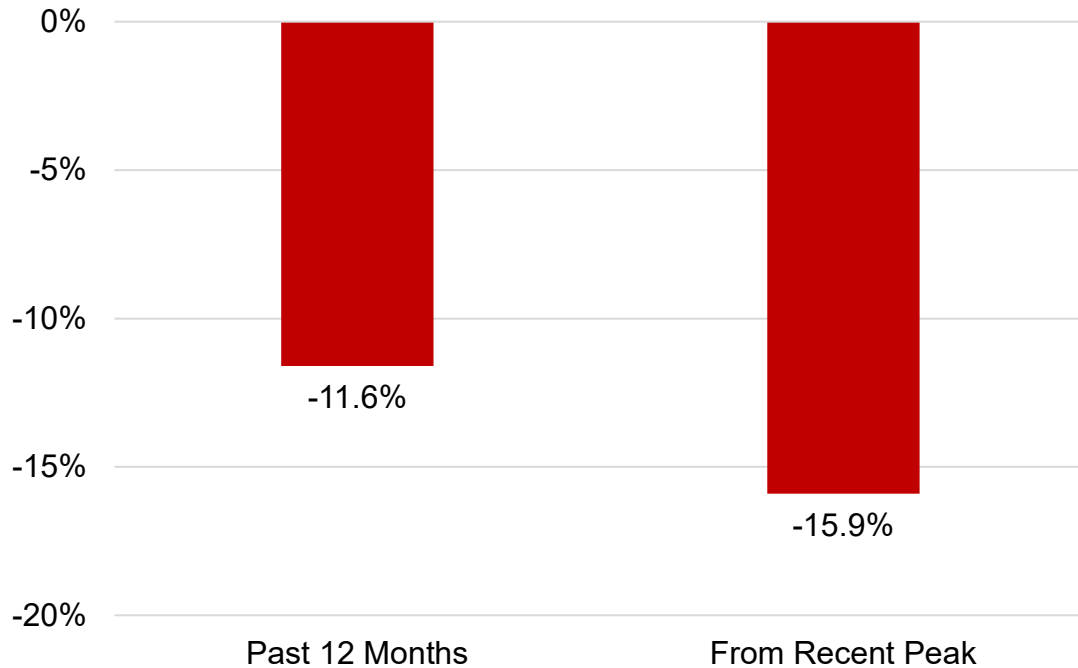
- Flat/declining rent growth
- Higher debt costs
- Increasing expenses
- Rising cap rates

Data: July 2023

Source: Greenstreet Advisors; FRB Atlanta – Center for Real Estate Excellence

Declining Value and Leverage = Increased Risk

Change in Commercial Property Values



From Peak: Office -31%, Apartment -21%, Mall -18%, Net Lease -16%

Source: Greenstreet Advisors; FRB Atlanta – Center for Real Estate Excellence

LTV at Origination

Decline in Value	LTV at Origination		
	65%	75%	85%
-5%	68%	79%	89%
-10%	72%	83%	94%
-15%	76%	88%	100%
-20%	81%	94%	106%
-25%	87%	100%	113%
-30%	93%	107%	121%
-35%	100%	115%	131%
-40%	108%	125%	142%

- 85% New LTV with Elevated Risk
- 100% New LTV with High Risk
- 120% New LTV with Ultra Risk

Data: Aug 2023

Closing

- Economic conditions remain healthy; however, growth is moderating.
- Greater risks in CRE are emerging:
 - Increasing interest rates are negatively pressuring property value.
 - Rising debt costs and stagnant/declining NOI impact cash flow.
 - Functional obsolescence will accelerate.
- Mitigation strategies:
 - Greater knowledge is better (e.g., borrower, property condition, tenants, and repayment source).
 - Sensitivity analyses can provide insight into risk (e.g., rents, expenses, debt, and cap rates).

Polling Question #4

Is the market you are active-in, being influenced by distressed commercial?

- A. Yes
- B. Maybe
- C. No
- D. Unsure

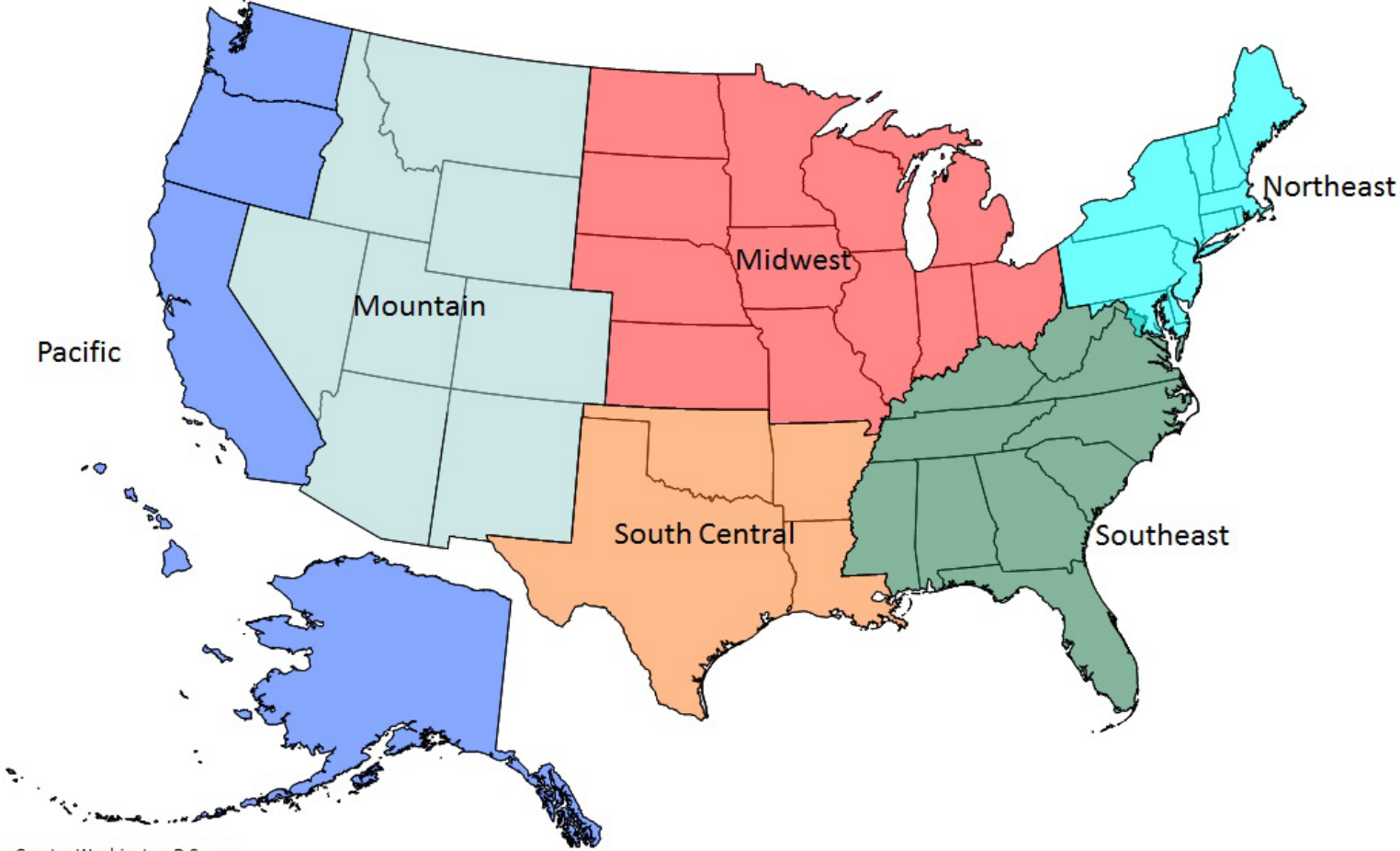
2023 National CRE Series

Regional CRE Updates

National
August 29, 2023

Mountain Region
September 27, 2023

Midwest
Northeast
South Central
Southeast
Coming in 2024



Note: Northeast includes the Greater Washington, D.C. area.

Session dates will be announced throughout 2023 and 2024. All sessions will be available at www.askthefed.org.

To Ask a Question

- Use the chat feature in the webinar.
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- Email your question to: questions@askthefed.org.
- Use the “Ask a Question” feature on the Ask the Fed[®] website:
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Acronyms

- ADR – average daily rate
- BLS – Bureau of Labor Statistics
- bp – basis point
- CPI – Consumer Price Index
- CRE – commercial real estate
- FOMC – Federal Open Market Committee
- LTV – loan-to-value
- NOI – net operating income
- RevPAR – revenue per available room
- SA – seasonally adjusted
- CMBS- Commercial Mortgage-Backed Security
- CLO- Collateralized Loan Obligation

Thanks for joining us.

www.askthefed.org