

NAIOP

COMMERCIAL REAL ESTATE
DEVELOPMENT ASSOCIATION

CHICAGO CHAPTER

2022 REAL ESTATE FORECAST

THURSDAY, JANUARY 20, 2022



GUEST SPEAKER

MARK J. EPPLI, Ph.D

Director

Graaskamp Center for Real Estate Wisconsin School of Business
University of Wisconsin - Madison



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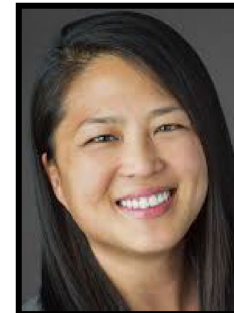
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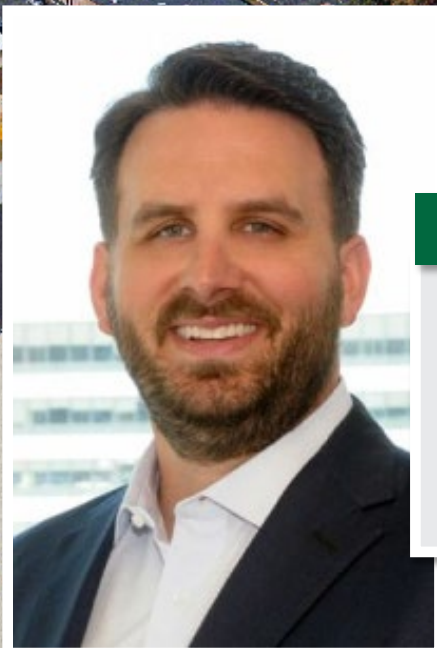
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2022 Macroeconomic and Real Estate Update and Forecast

Mark J. Eppli, Ph.D.
Director, Graaskamp Center for Real Estate
January 2021

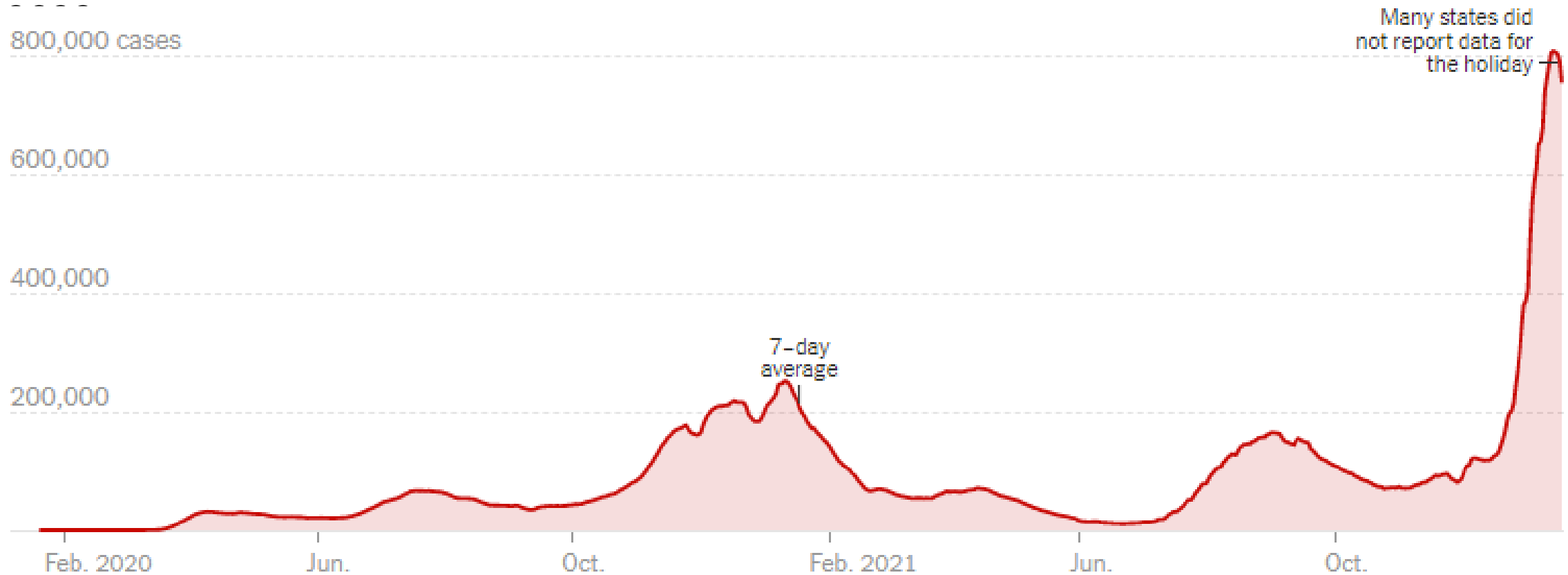
Year in Review and 2022 Forecast

- I. Covid
- II. Product Inflation (supply of and demand for goods/services)
 - A. GDP
 - B. Fiscal Stimulus
 - C. Labor
- III. Asset Inflation (supply of and demand for capital)
 - A. Monetary Stimulus
 - B. Capital Availability
- IV. Property Types

Covid

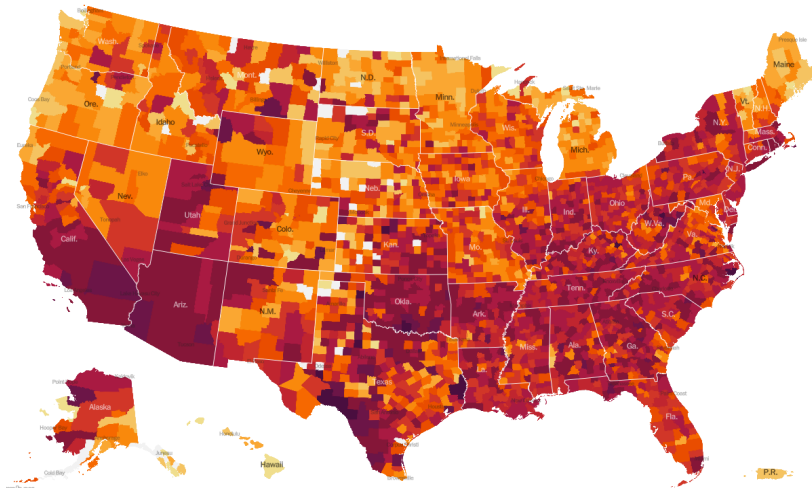
Omicron Covid cases are peaking (7-day average = 756,000) . . .

New Weekly Average Covid Cases through January 19,

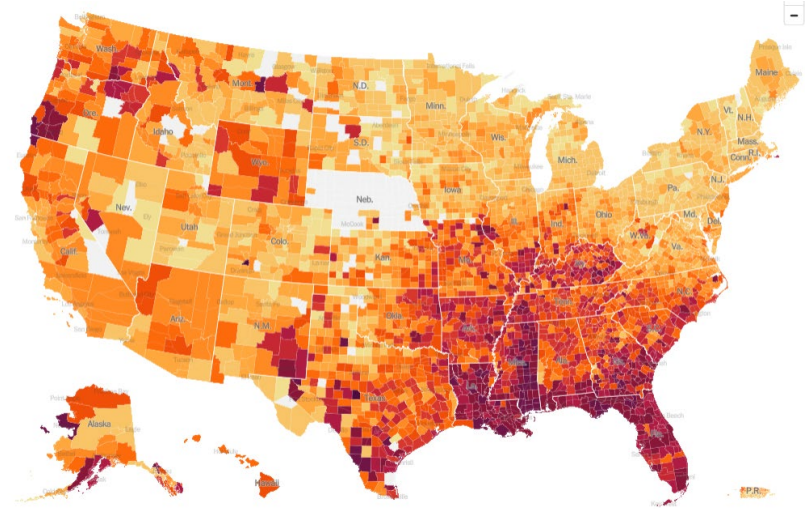


. . . . the Beta, Delta, and Omicron variants

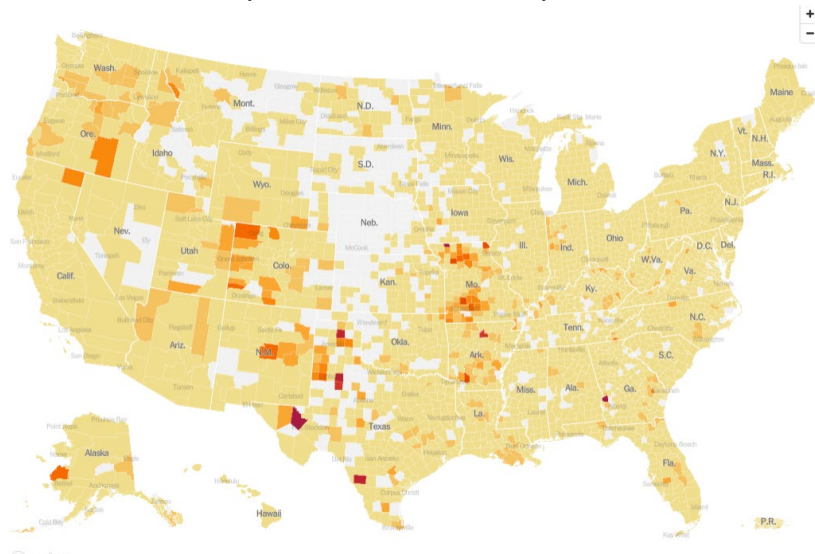
Beta Variant, Cases January 12, 2021



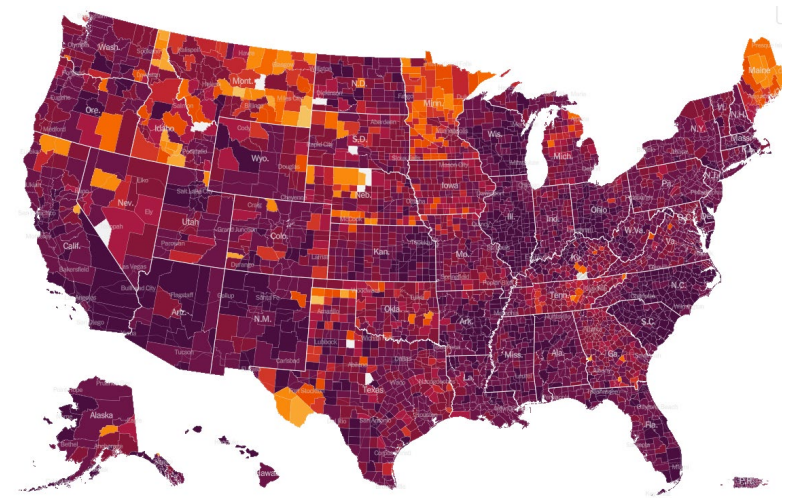
Delta Variant, Cases August 16, 2021



No Variant, Cases June 19, 2021

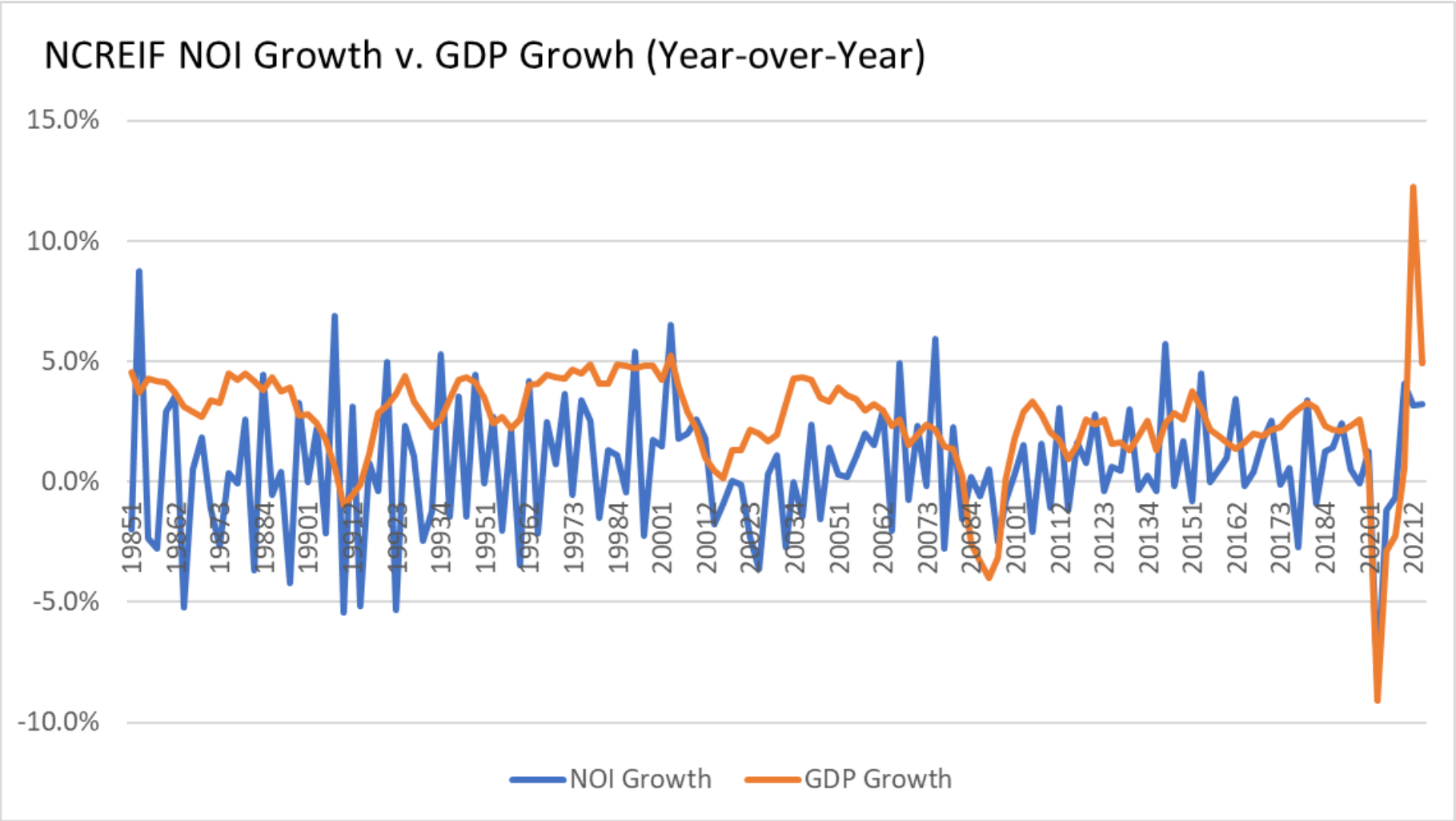


Omicron Variant, Cases , January 19, 2022

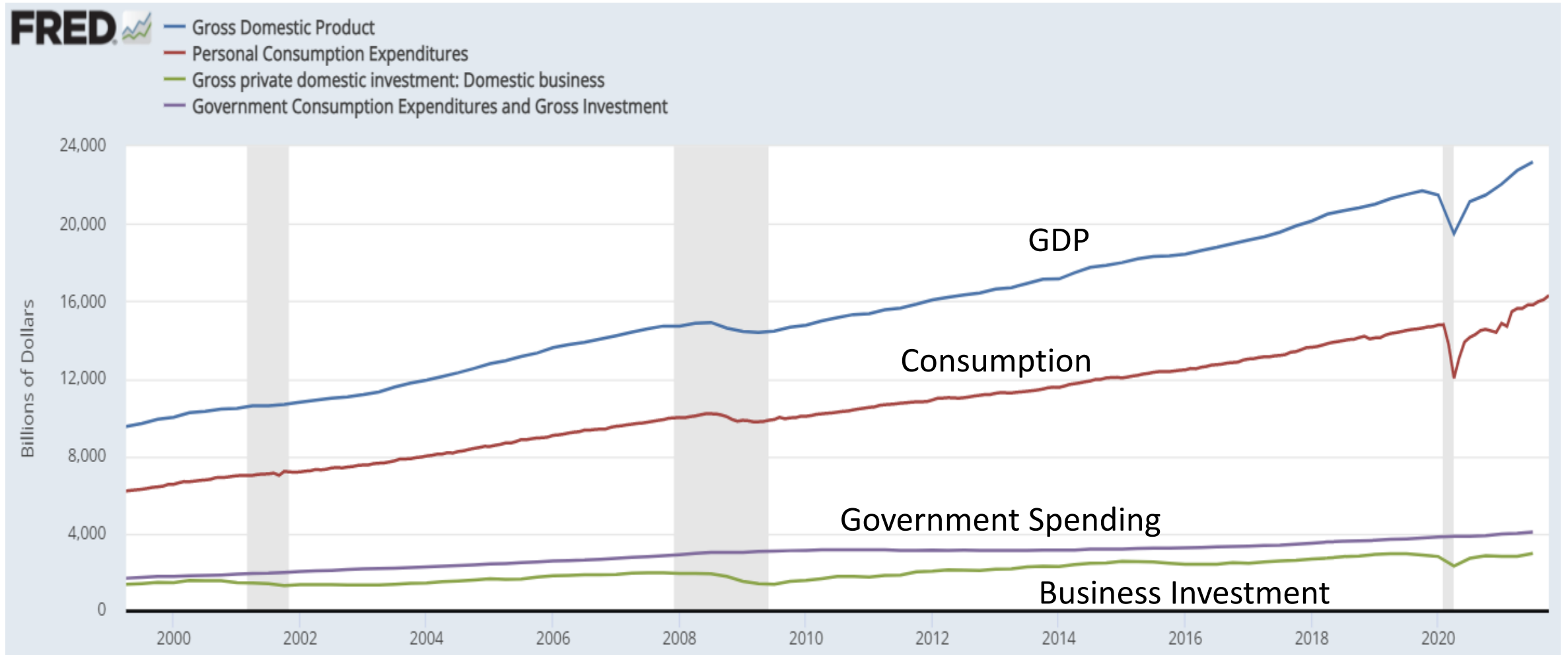


GDP

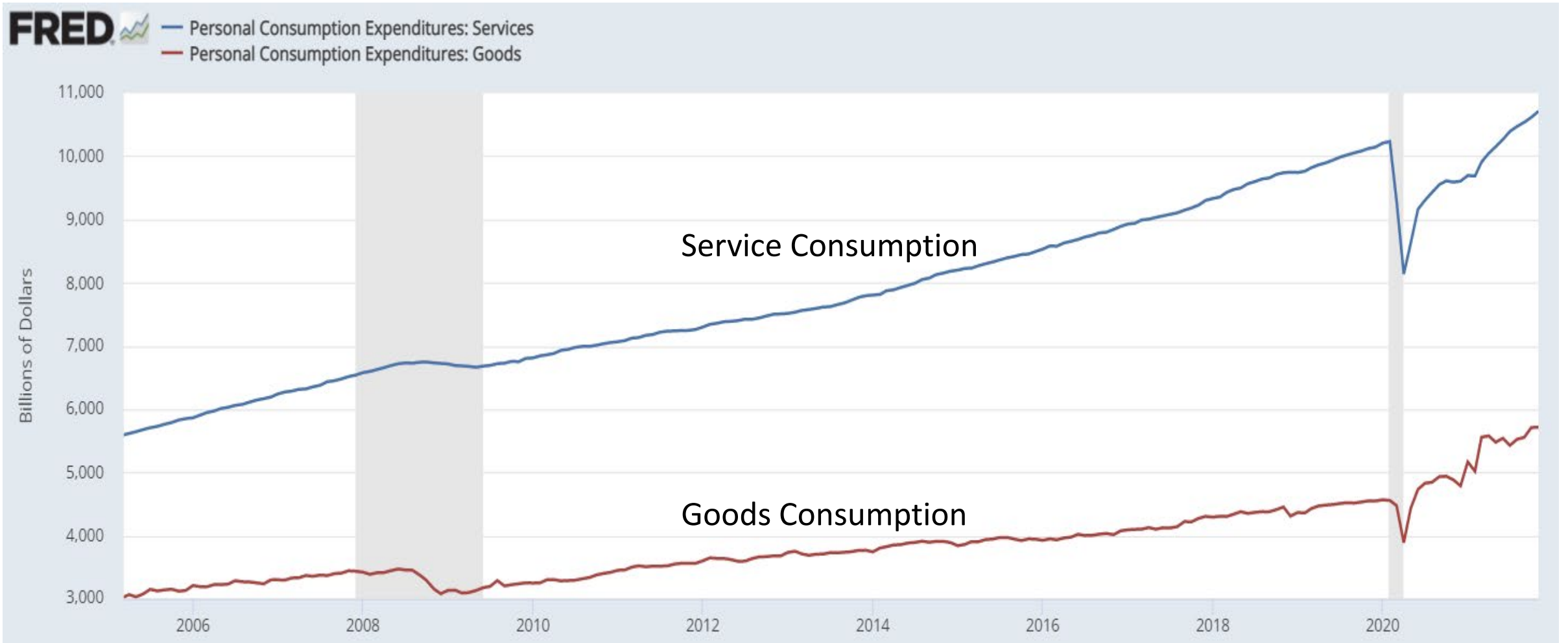
GDP growth impacts and leads NOI growth . . .



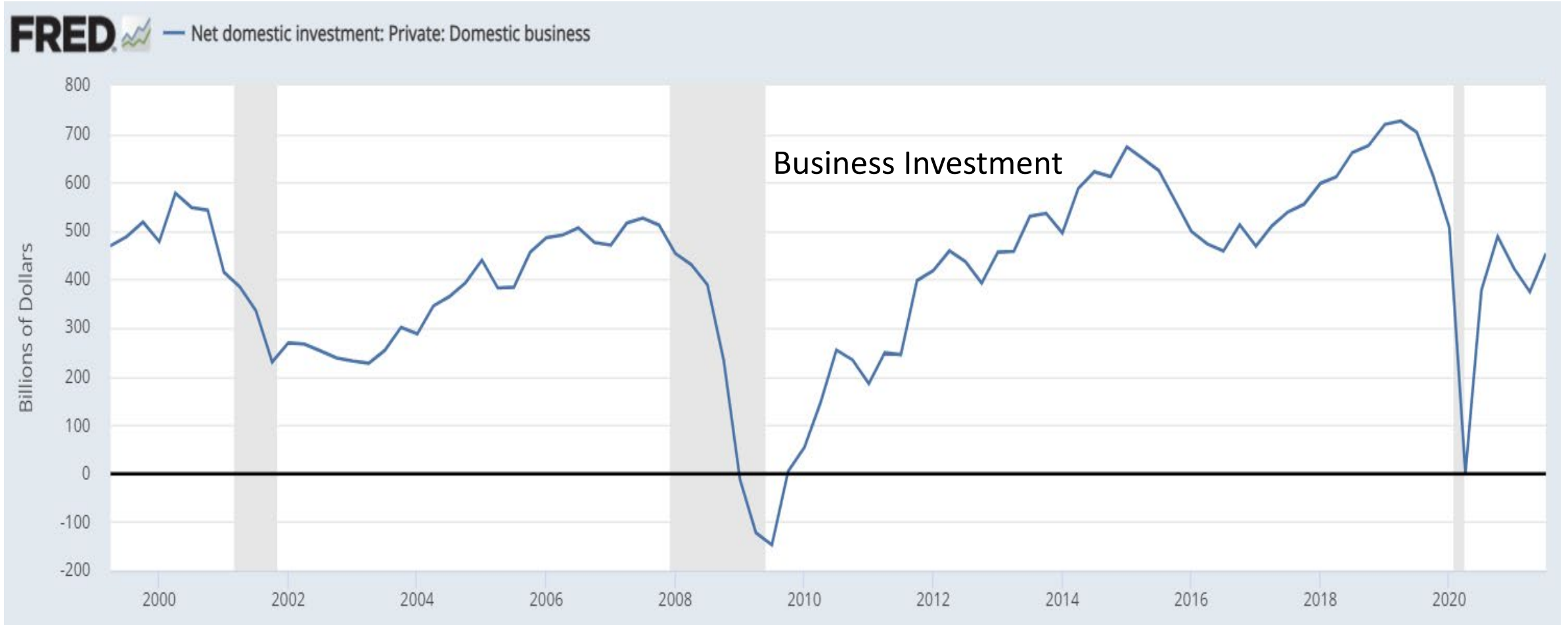
Nominal GDP growth was disrupted by the pandemic



... the level of goods and service consumption is driven by Covid . .

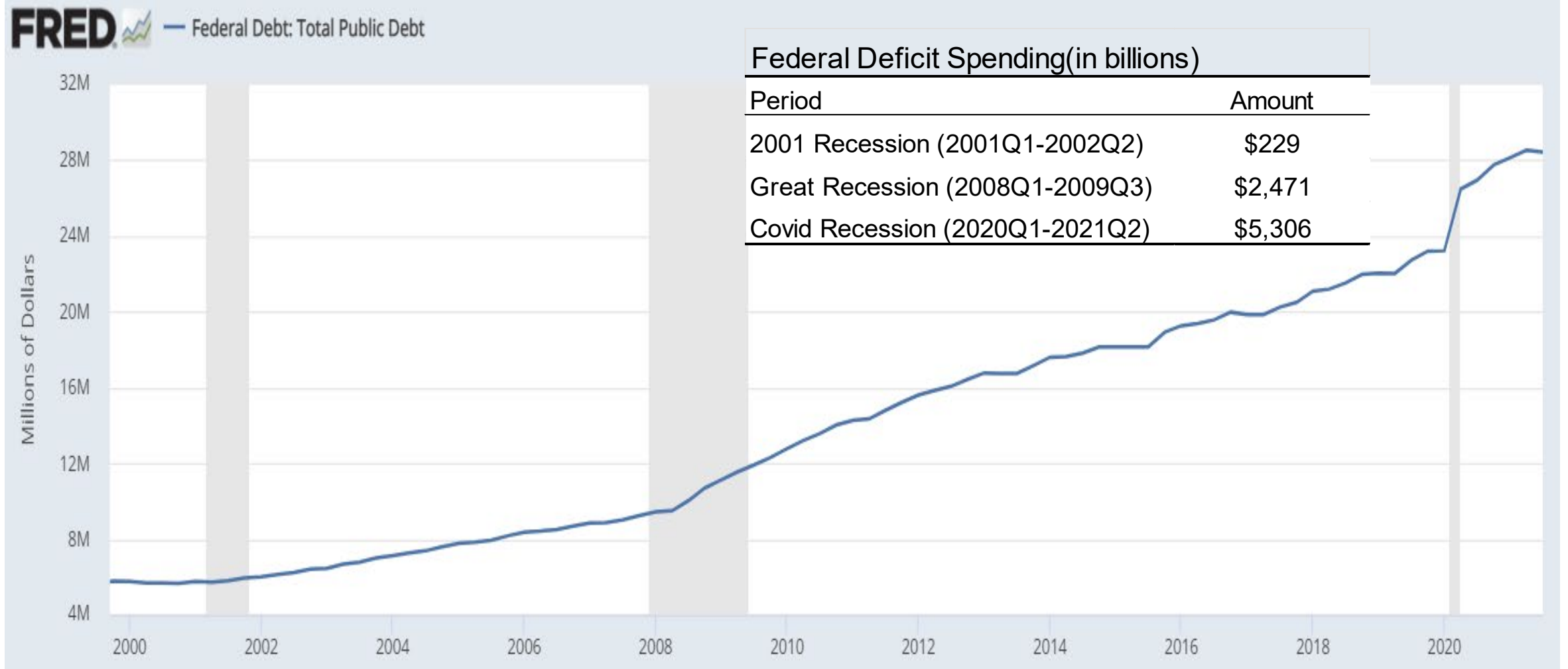


. . . . business investment, a relatively small contributor to GDP, is very volatile. . .

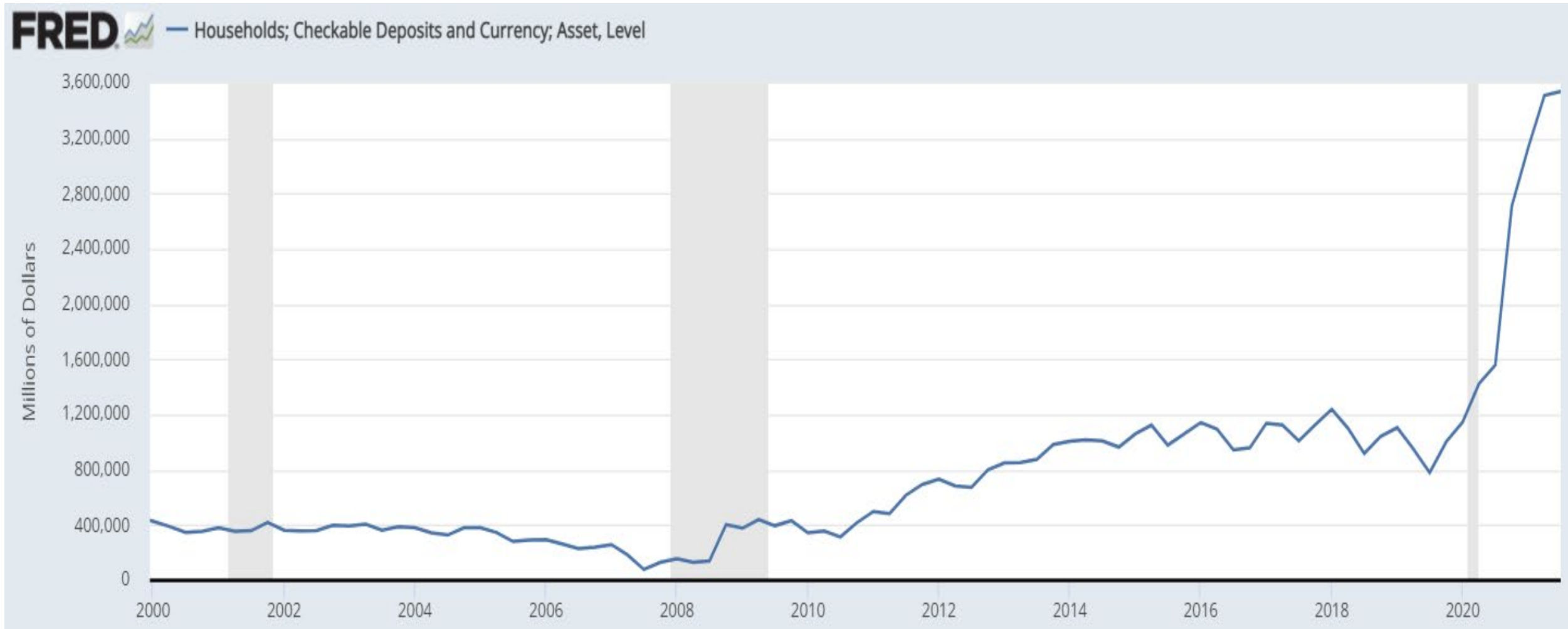


Fiscal Stimulus

Covid fiscal stimulus is unprecedented

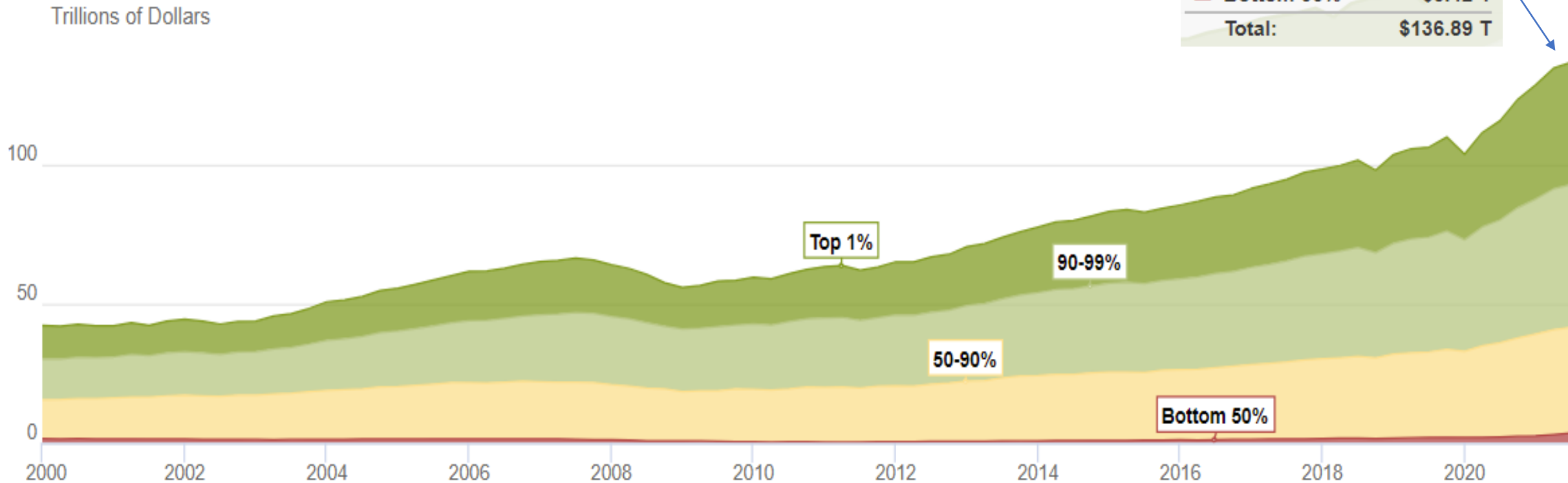


...most of the consumer Covid stimulus remains unspent. . . .

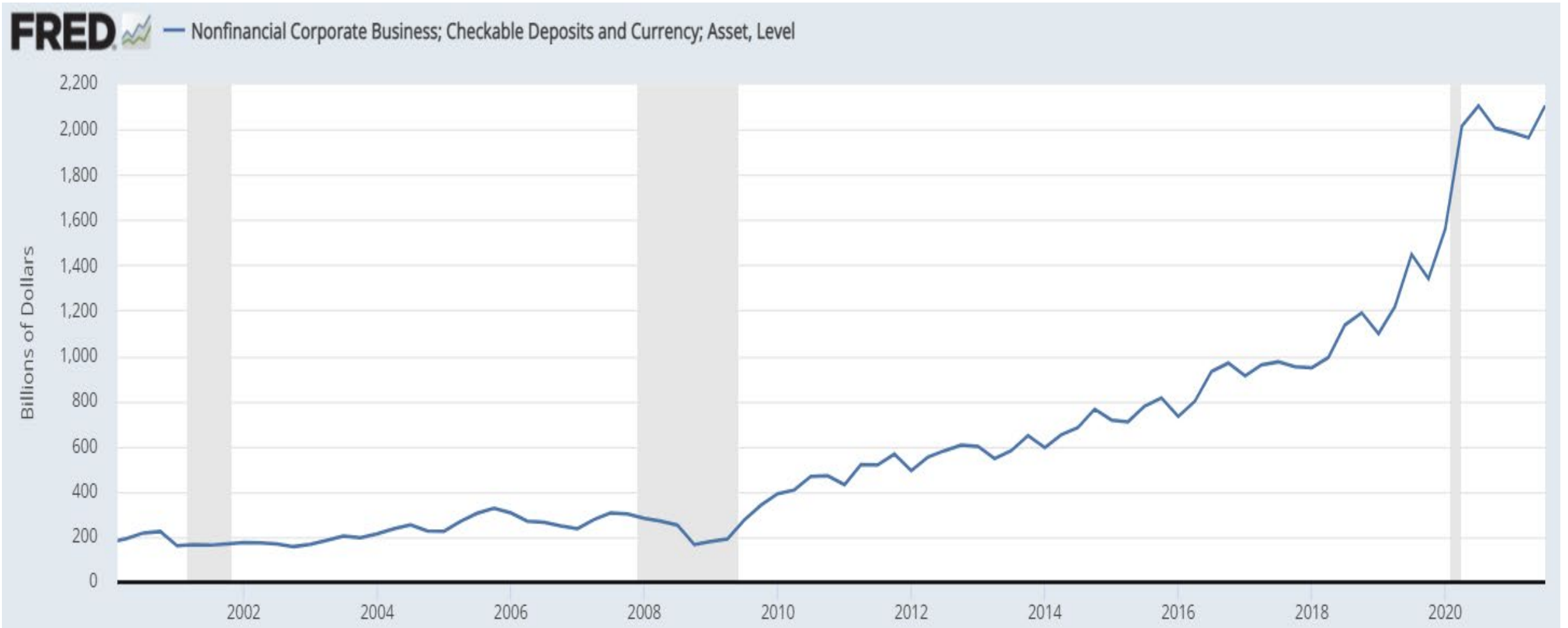


... wealth is up \$32 trillion since 2020Q1 and is concentrated among the rich. ...

Wealth by wealth percentile group



Shifting to Business: many PPP funds remain unspent.

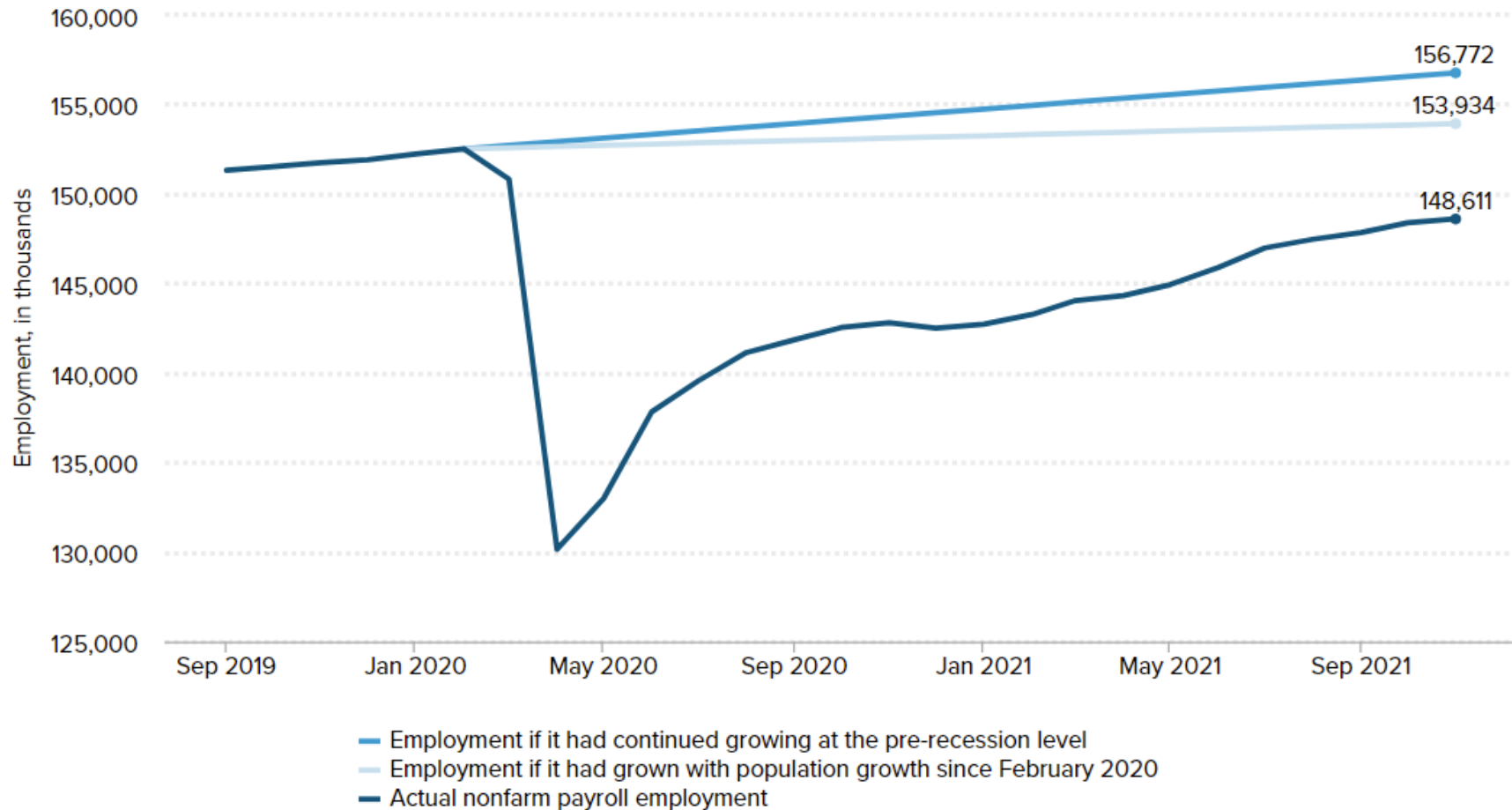


Labor

The path back to full employment is taking the shape of the Nike-swoosh

Measuring the job shortfall since February 2020

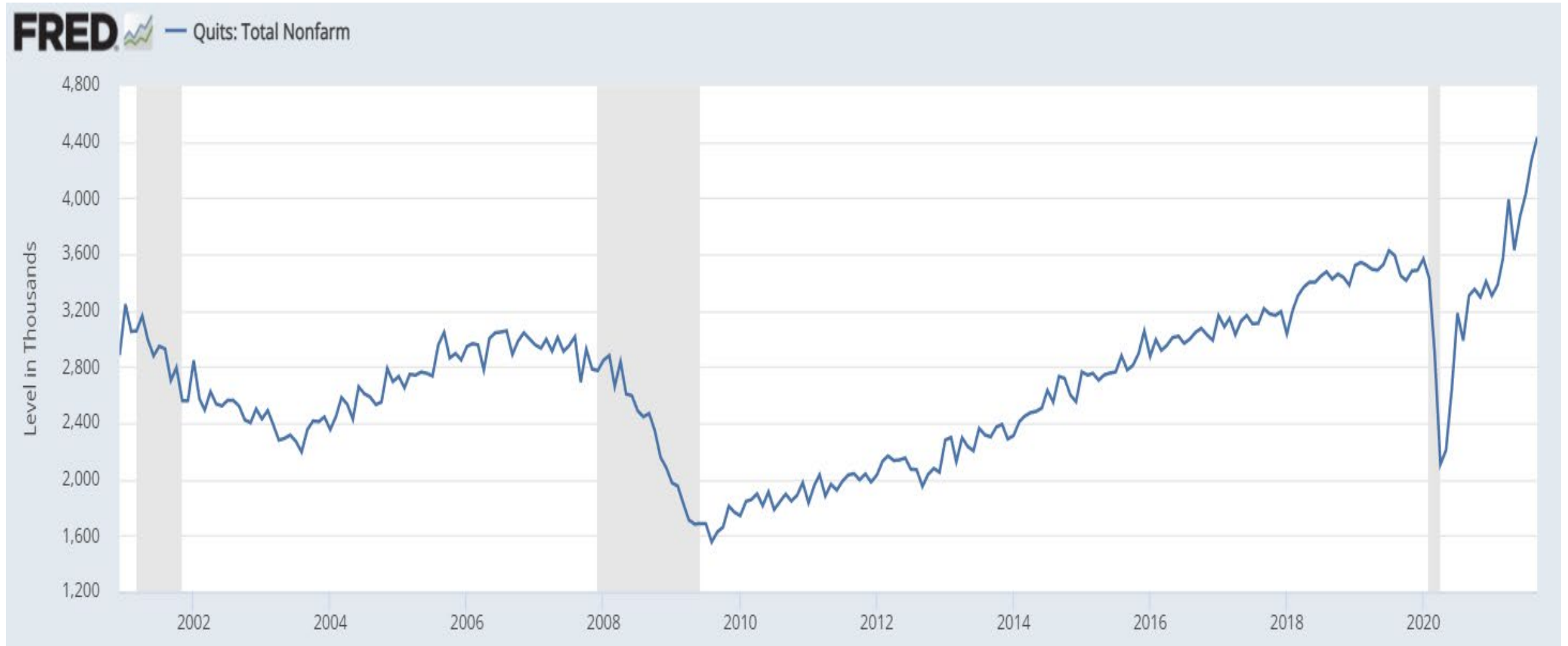
Actual and counterfactual employment, January 2019–November 2021



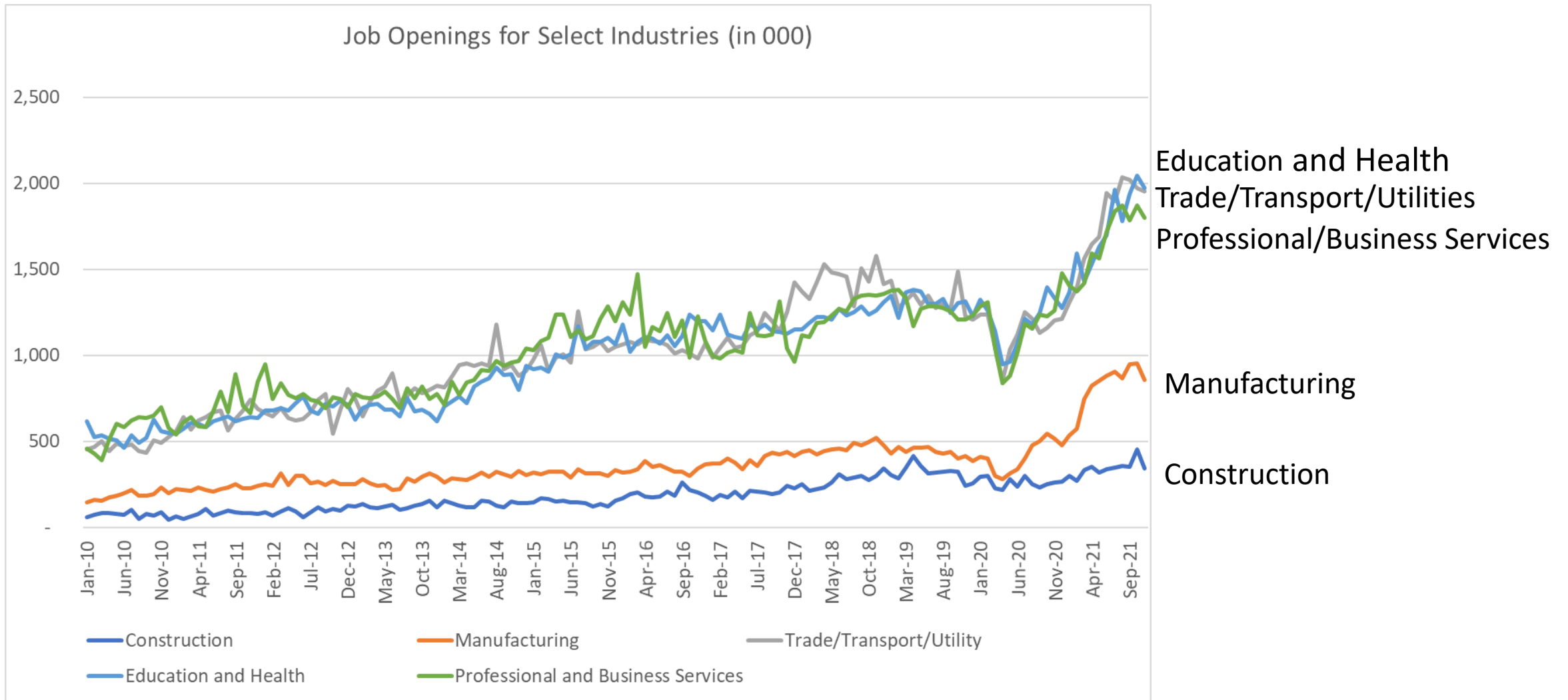
... labor force growth is not keeping pace with job openings (think worker confidence) ...



... voluntary employment quits are at an all-time high (think worker confidence) ...



... the worker shortage is broad-based ...



Key Goods/Service Inflation Take Aways

Product Inflation – Covid shifted purchases to Goods from Services

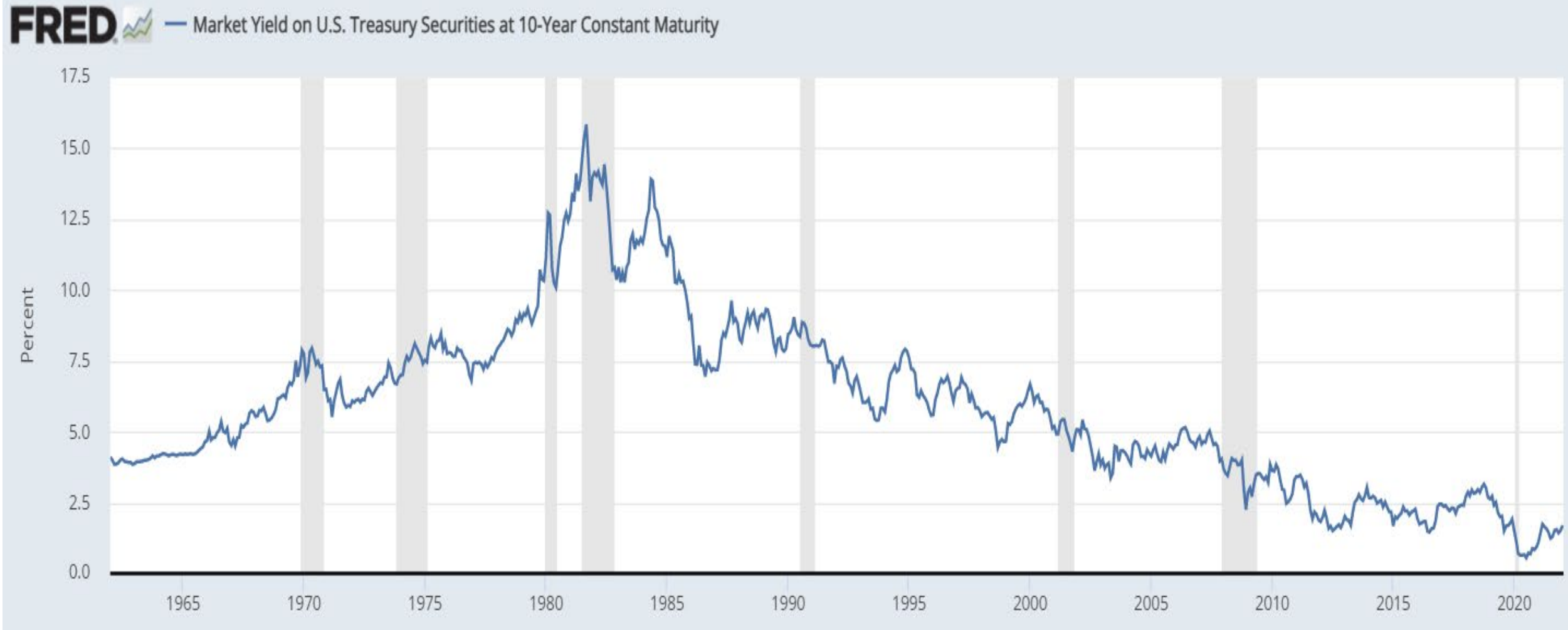
- Consumption disruptions generate transitory inflation with transitions throughout 2022 – **expect higher inflation than Fed estimates in the short term (2022 and into 2023)**
- Service inflation is employment/wage driven, a 3.9% unemployment rate today with 3.5 million fewer workers today than in February 2020 – **expect wage inflation that keeps CPI higher than Fed estimates in the medium term**
- Business investment will keep worker demand strong – CFOs need to invest to grow the bottom line – **expect wage inflation that keeps CPI higher than Fed estimates in the medium term**

Monetary Stimulus

\$4.8 trillion in Fed monetary stimulus



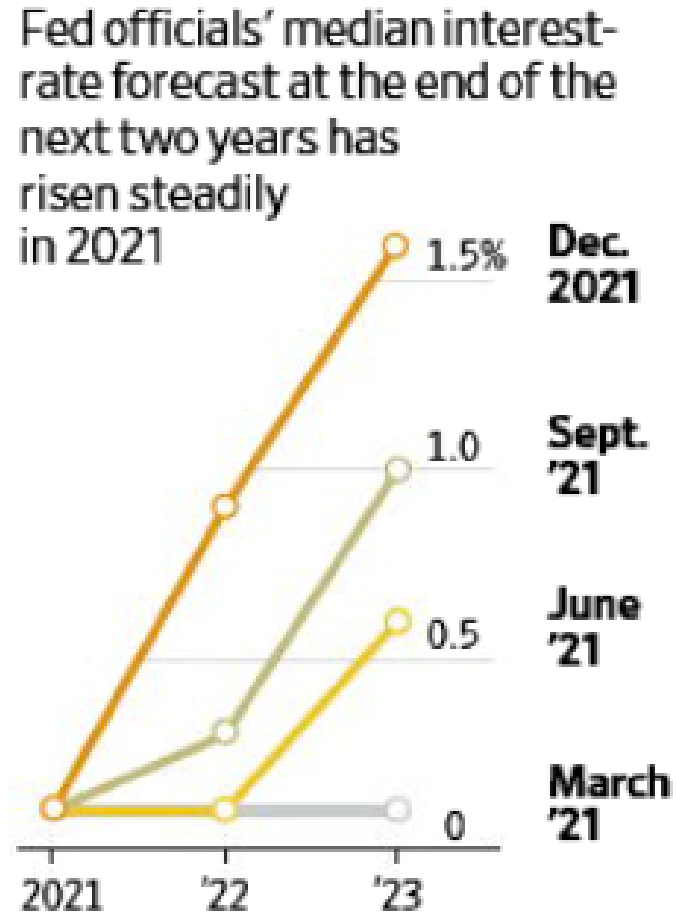
. . . . pushing down interest rates to near historic lows



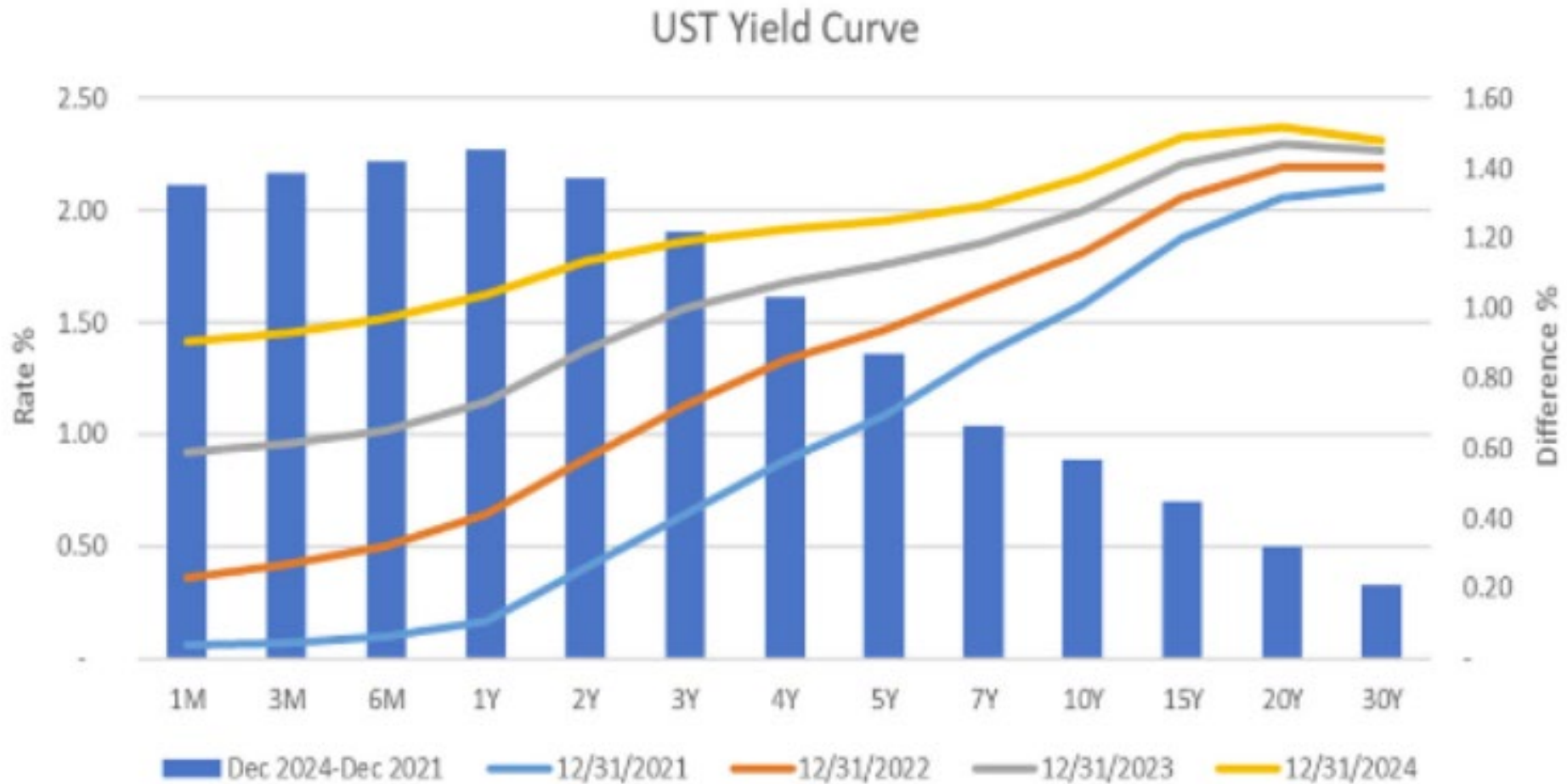
... implied inflation is 2.8% over the next 5-years (2000-2020, CPI = 2.14 and PCE = 1.83%).



. . . . the Fed's ever-changing rate forecast . . .



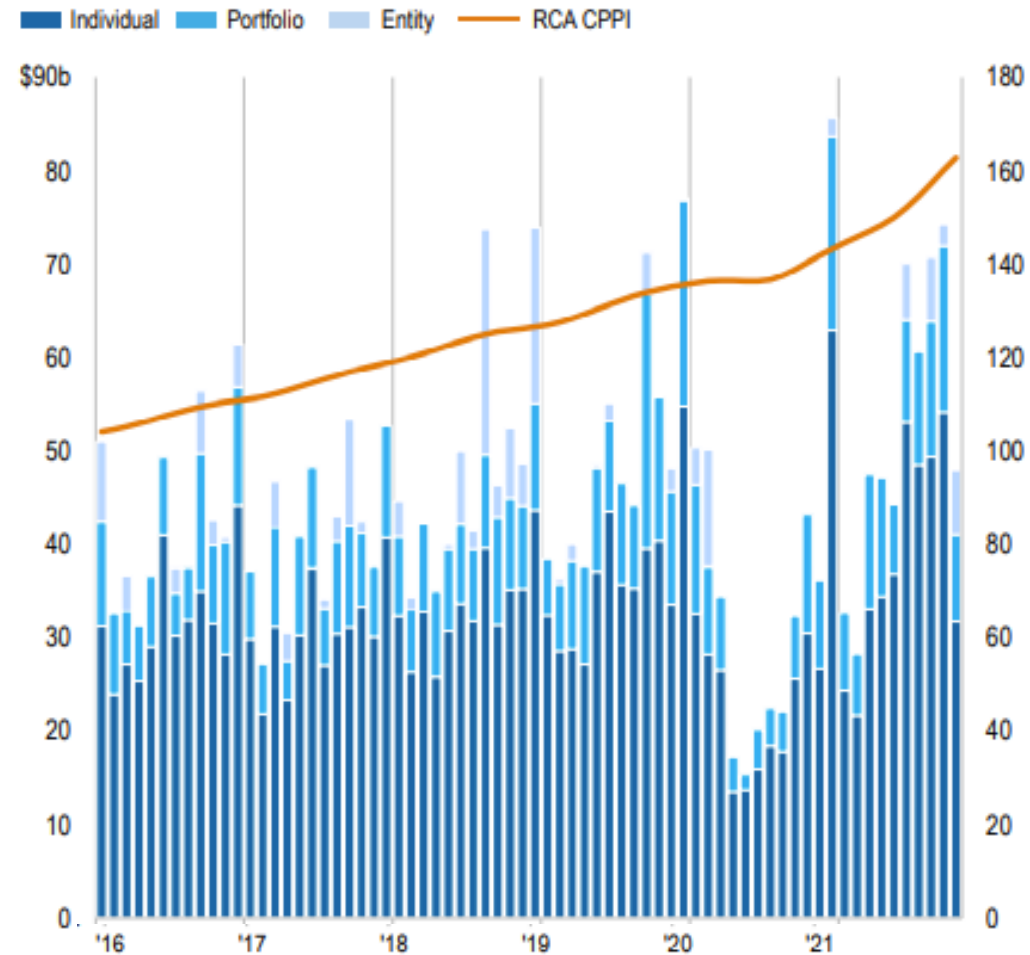
... Implied yield curves and rate changes.



Real Estate Capital Markets

Real estate transaction volume is strong. . . .

Monthly Transaction Volume & Pricing

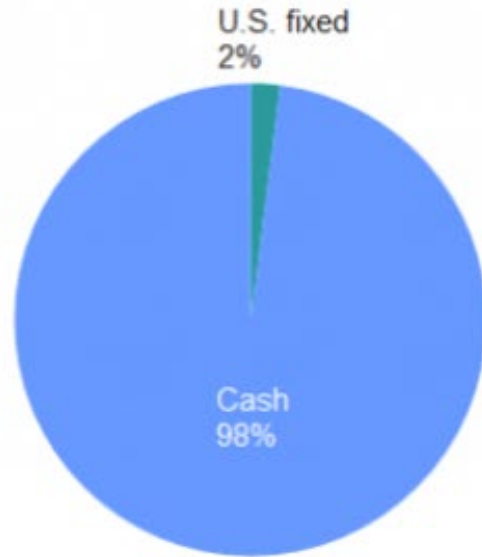


. . . . private equity is abundant



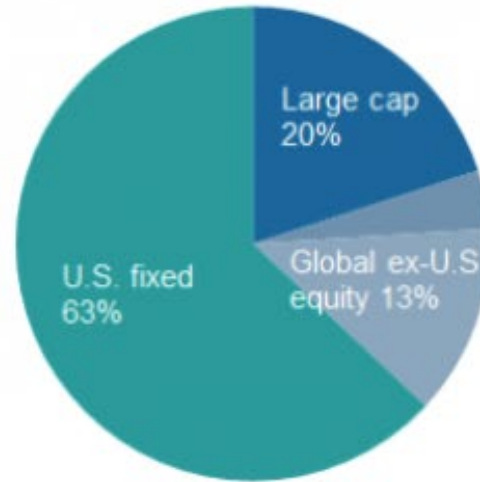
. . . . pension investment in equity real estate will remain strong

Investment Allocation and Investment Risk Required to Meet Target Returns



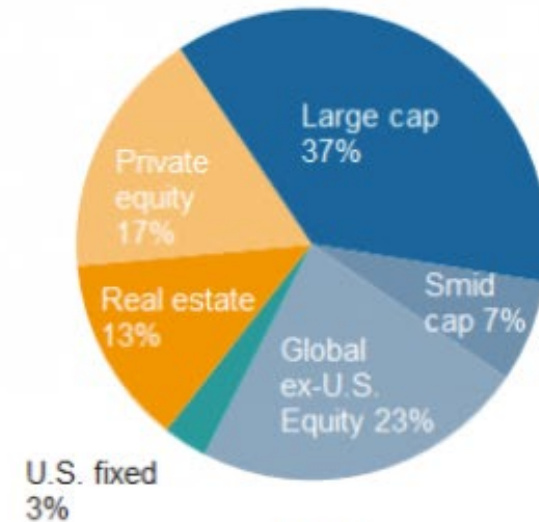
1991

Return: 7.0%
Risk: 1.1%



2006

Return: 7.0%
Risk: 6.7%

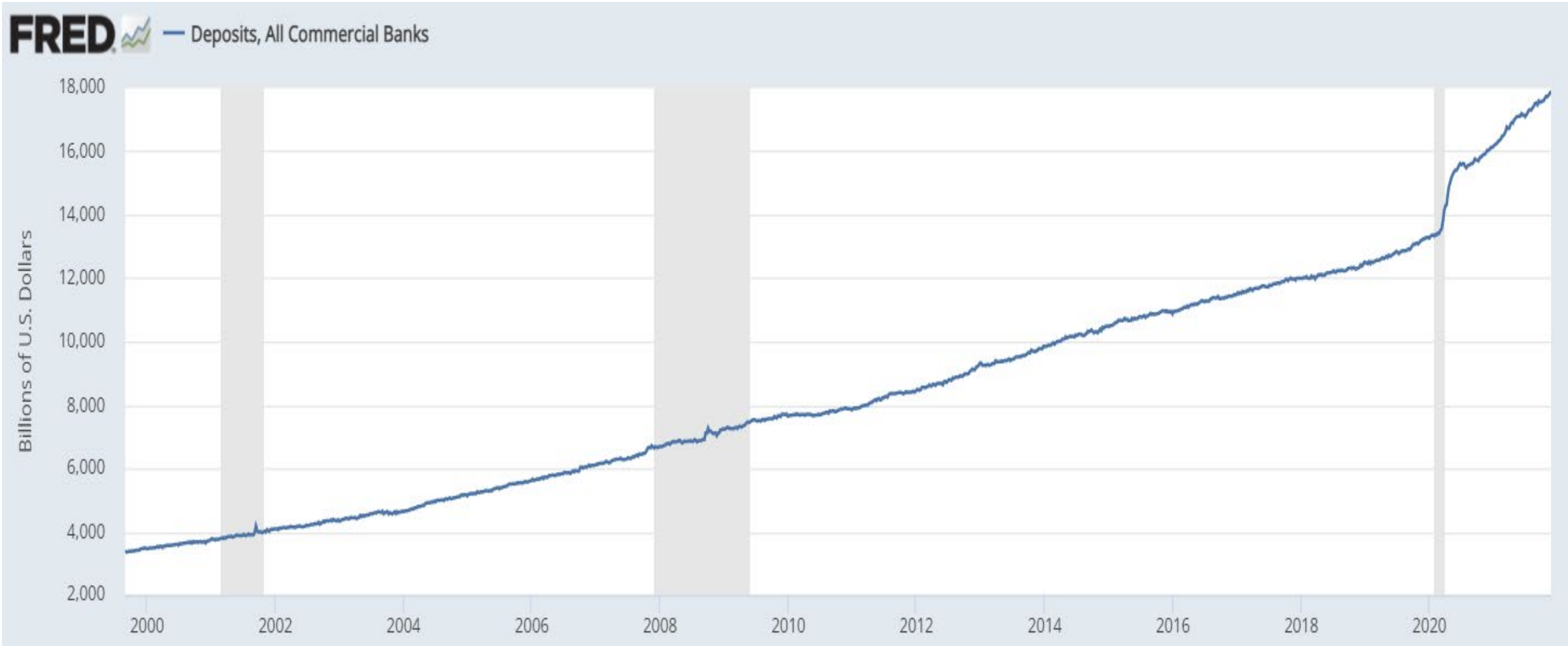


2021

Return: 7.0%
Risk: 17.3%

Increasing Risk

Banks have a surfeit of deposits and will *need* to lend



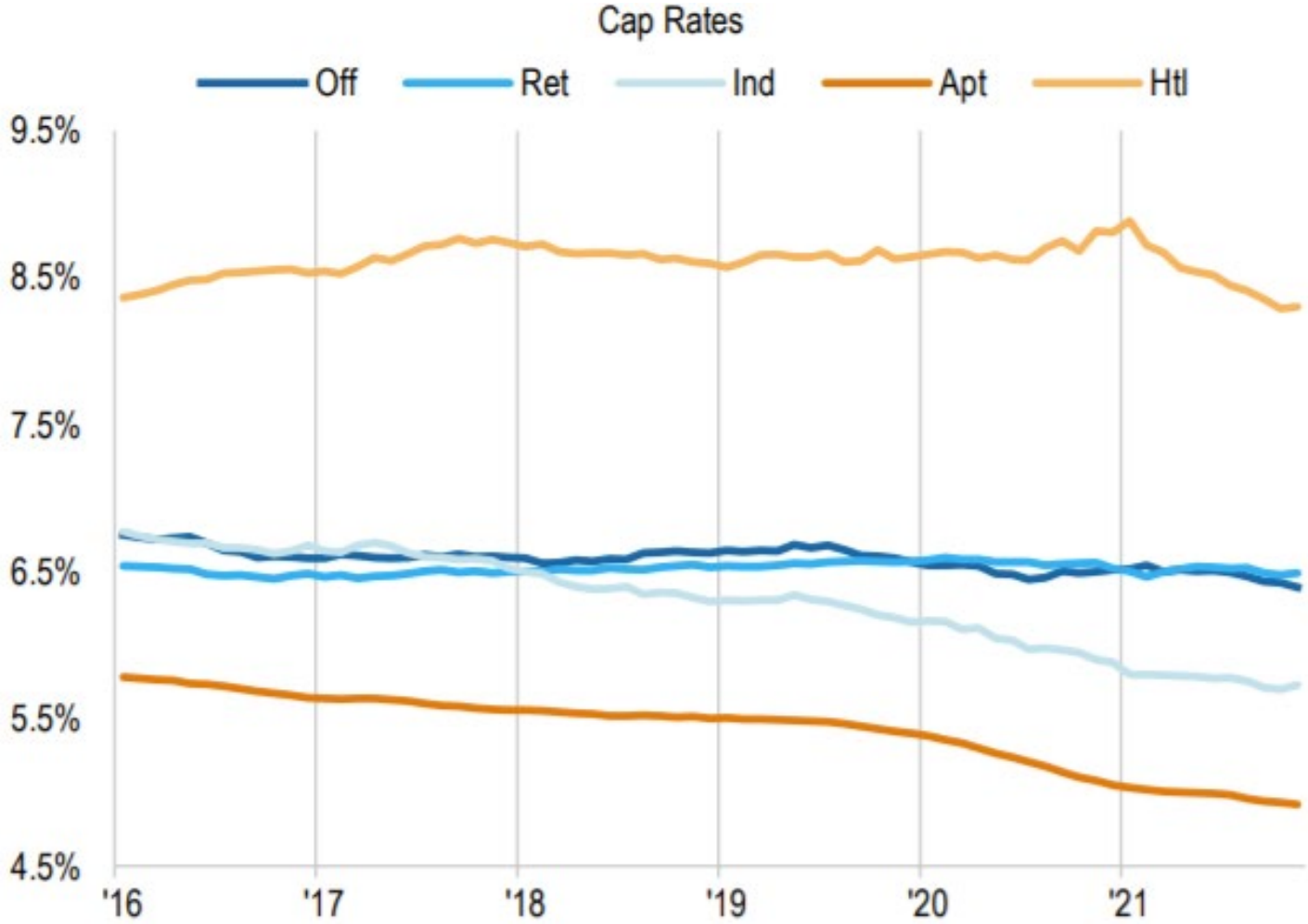
Monetary Policy and Capital Markets

Asset Inflation

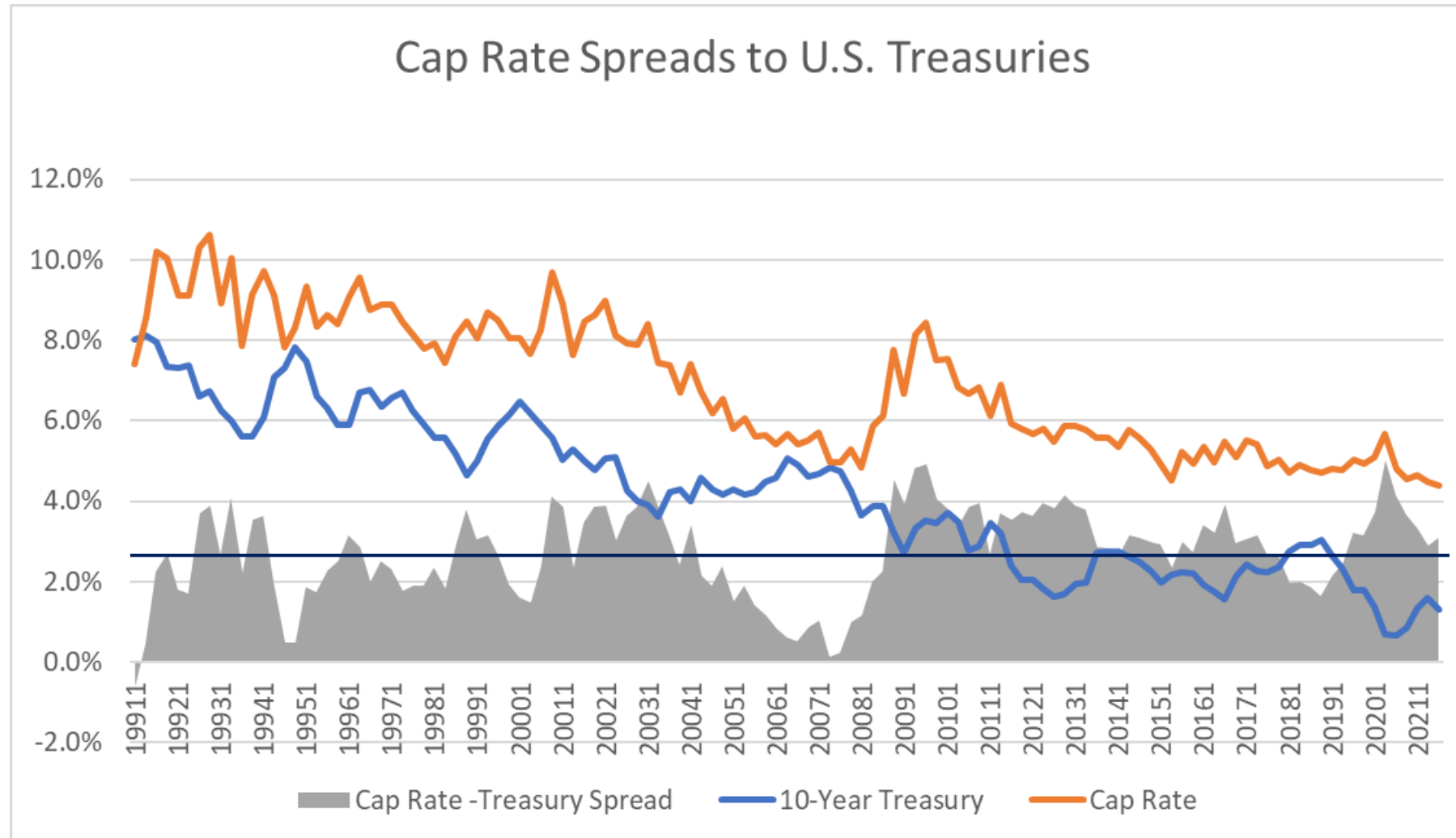
- Monetary and fiscal stimulus has banks/capital markets awash in funds, which will keep rates relatively low and appreciation elevated through 2022 and 2023
- Private, public, and institutional equity seeks (needs?) higher returns than BBB bonds provide, which keeps investor risk premiums and cap rates low.

Cap Rates

Property cap rates continue to drift lower especially for industrial and multifamily. . . .

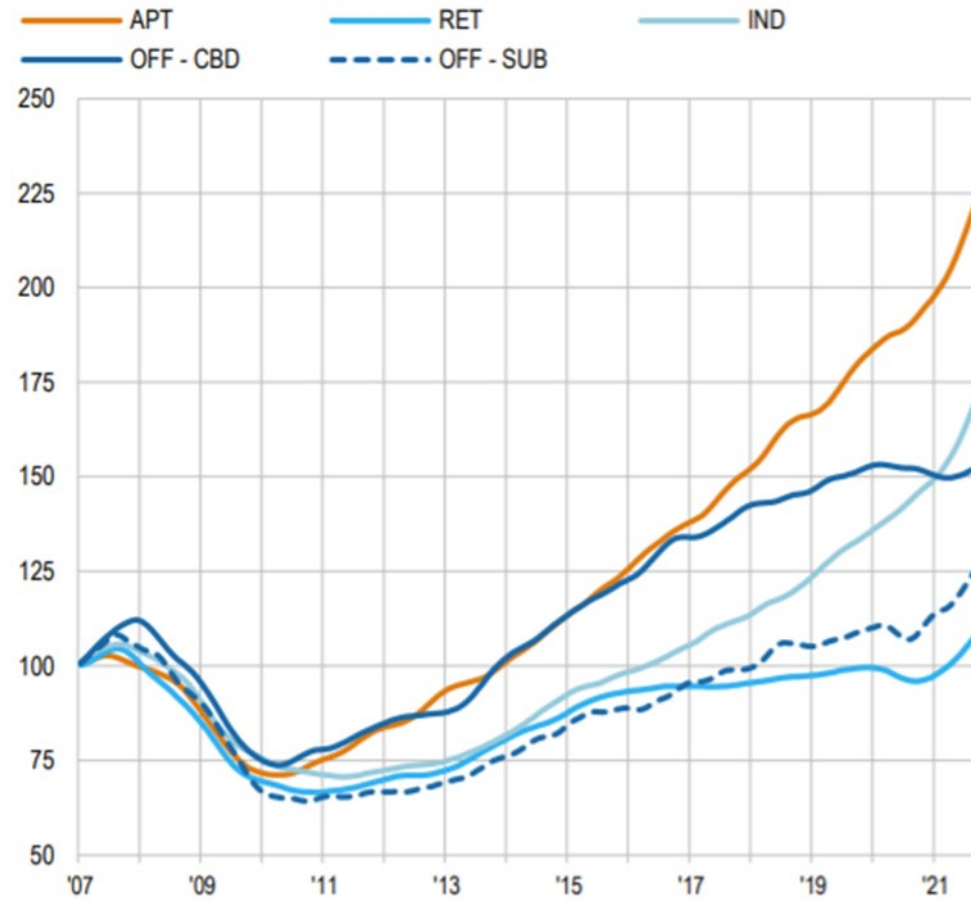


. . . . real estate retains solid spreads over U.S. Treasuries (good relative pricing). . . .



. . . . apartment and industrial cap rates compression and NOI growth have increased prices.

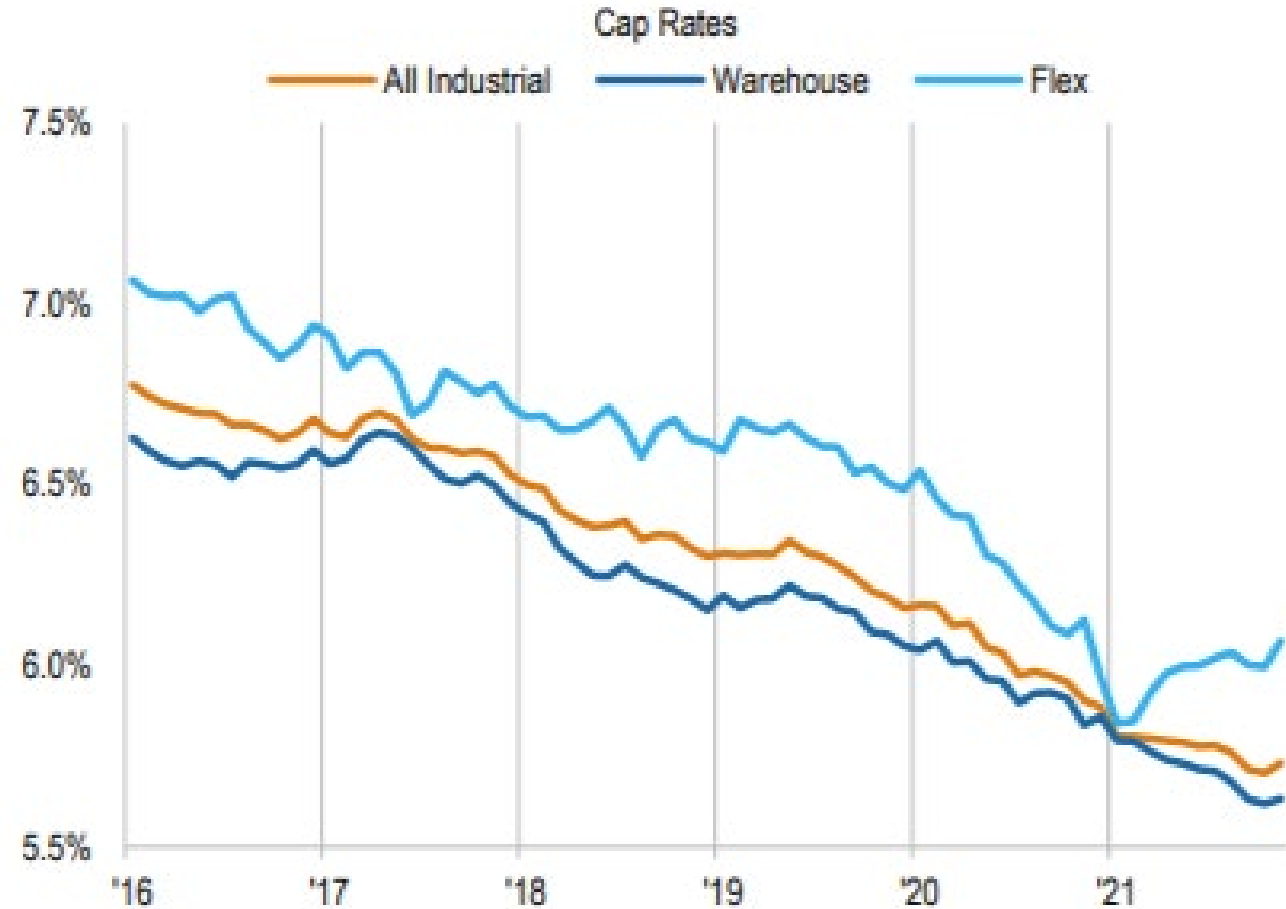
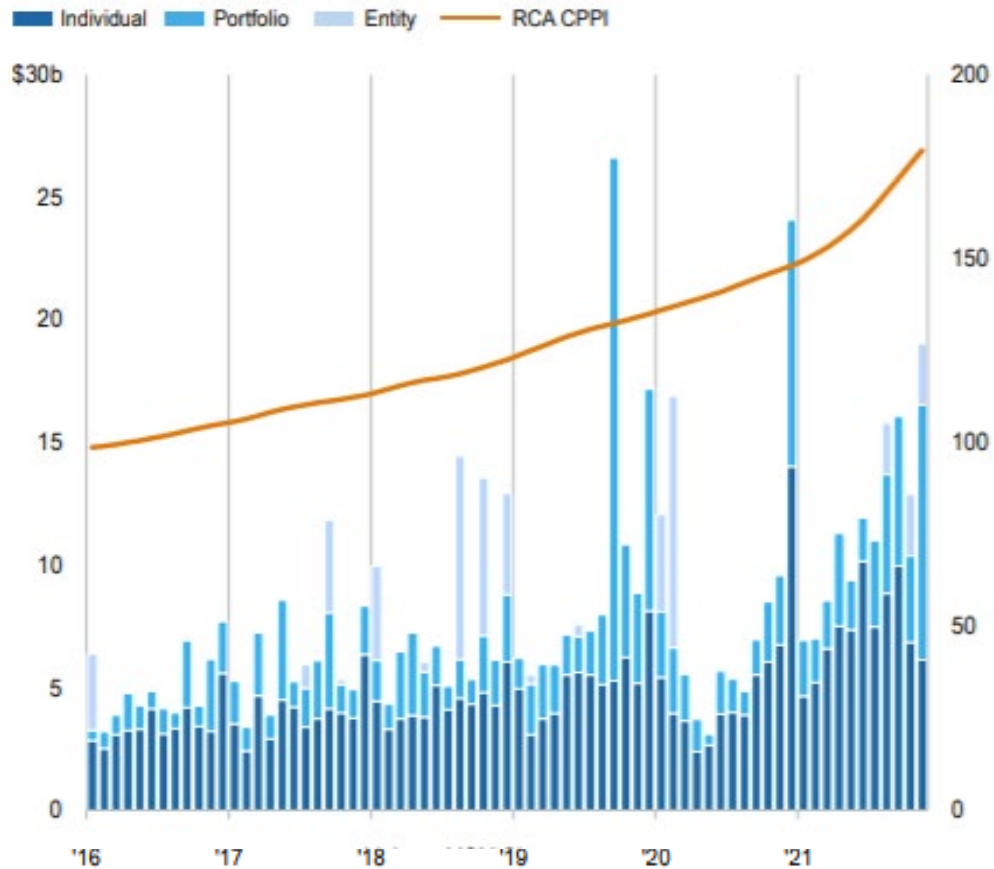
National Property Types



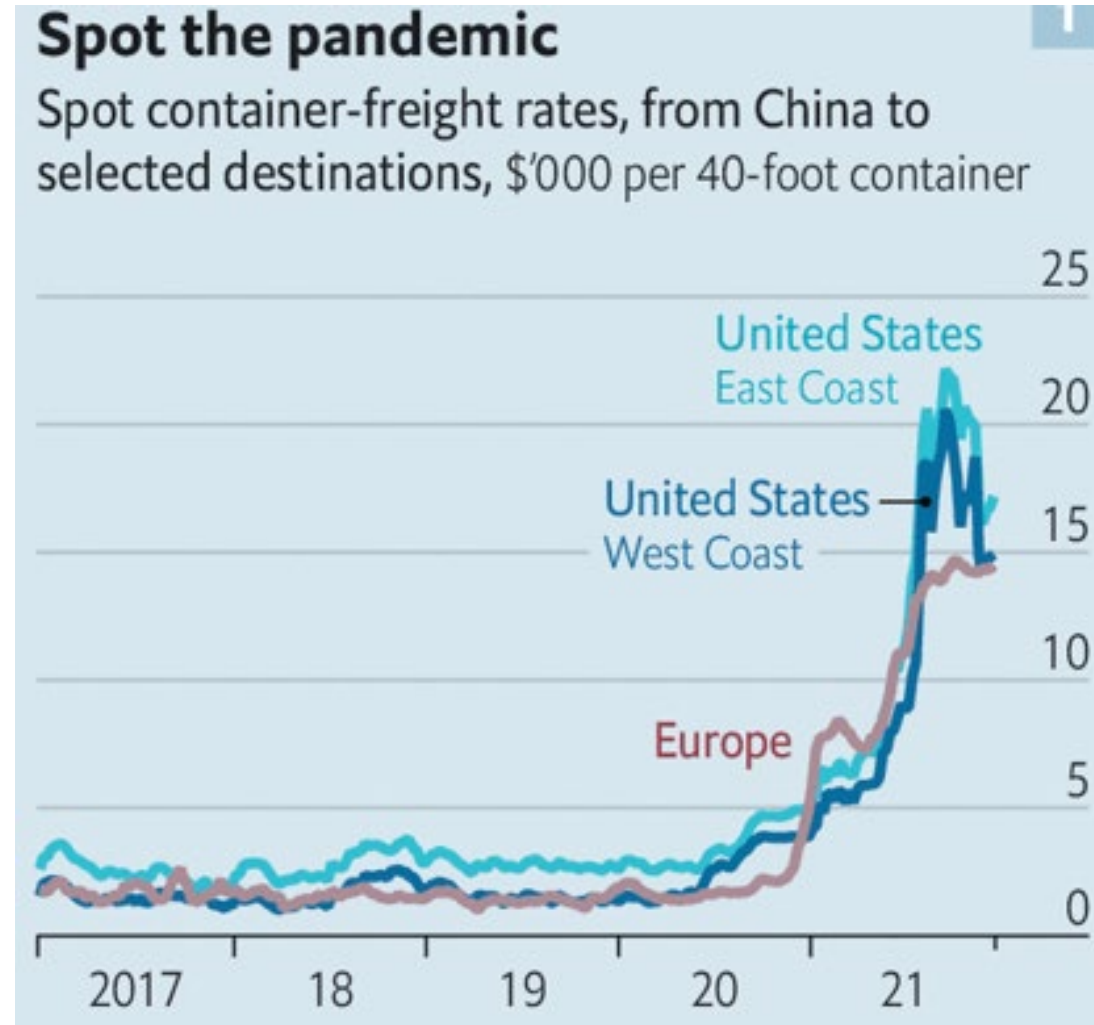
Property Types

Industrial transaction volumes are ramping up with declining cap rates

Monthly Transaction Volume & Pricing

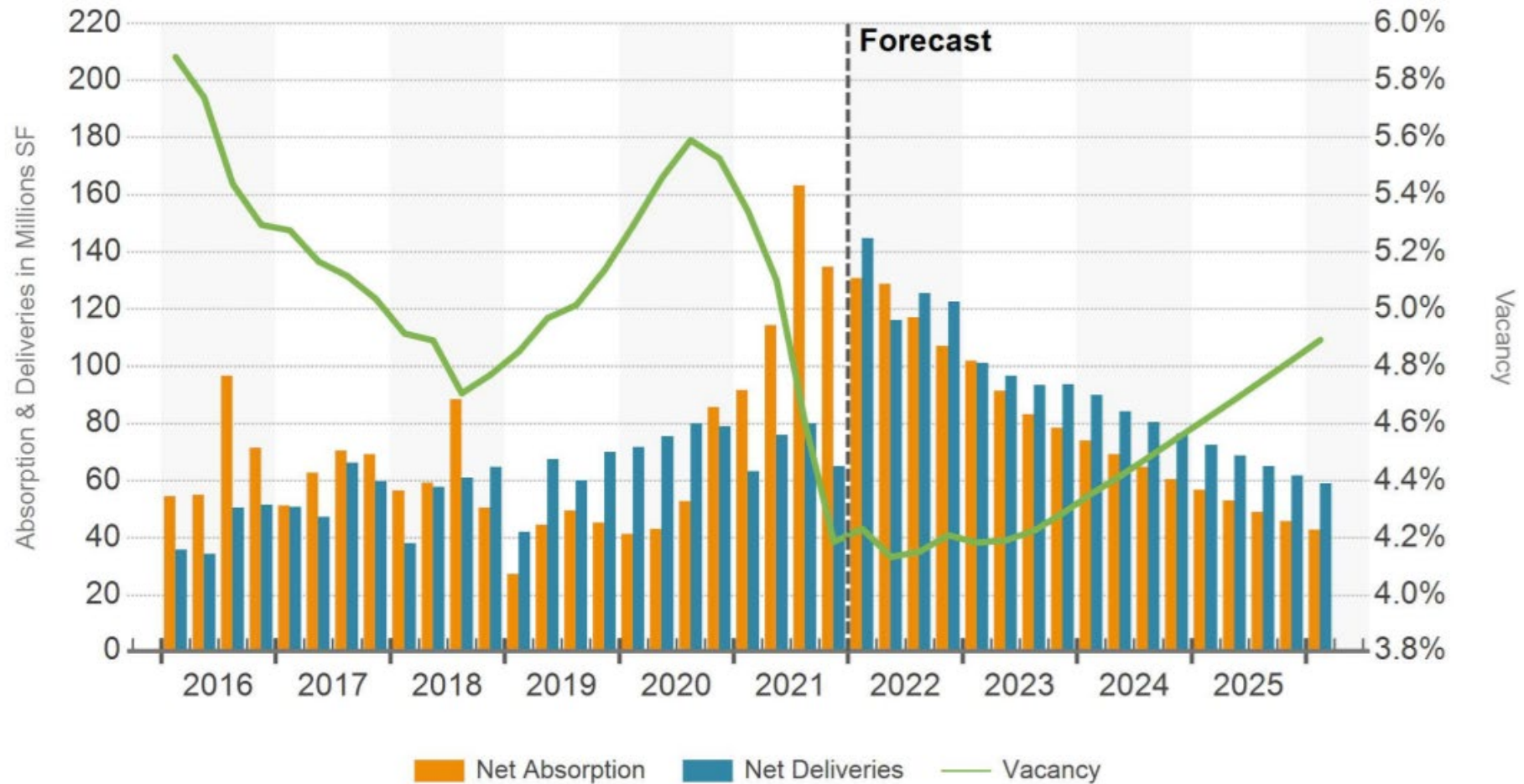


. . . . the shift to consumption goods is driving global supply chain snarls



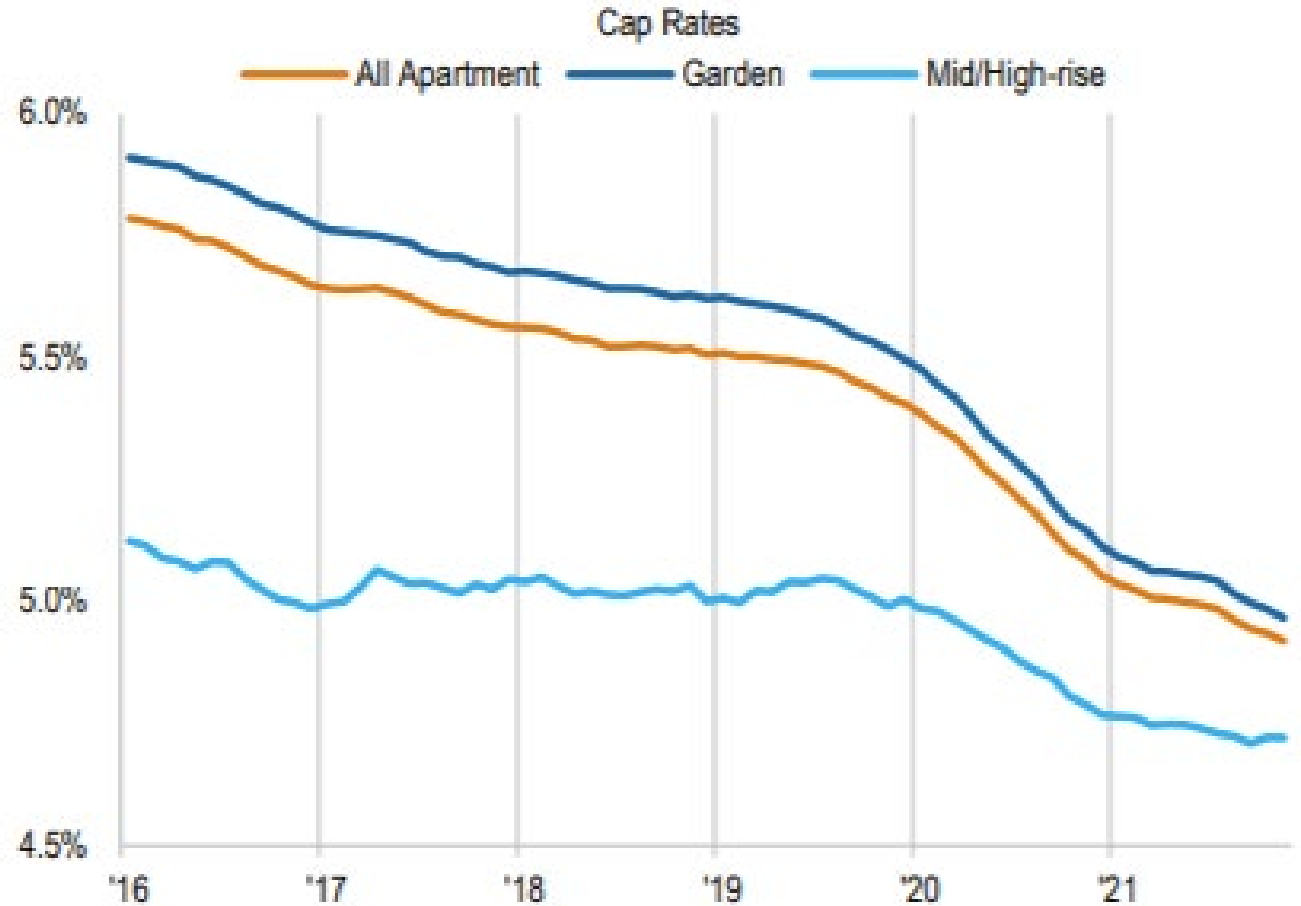
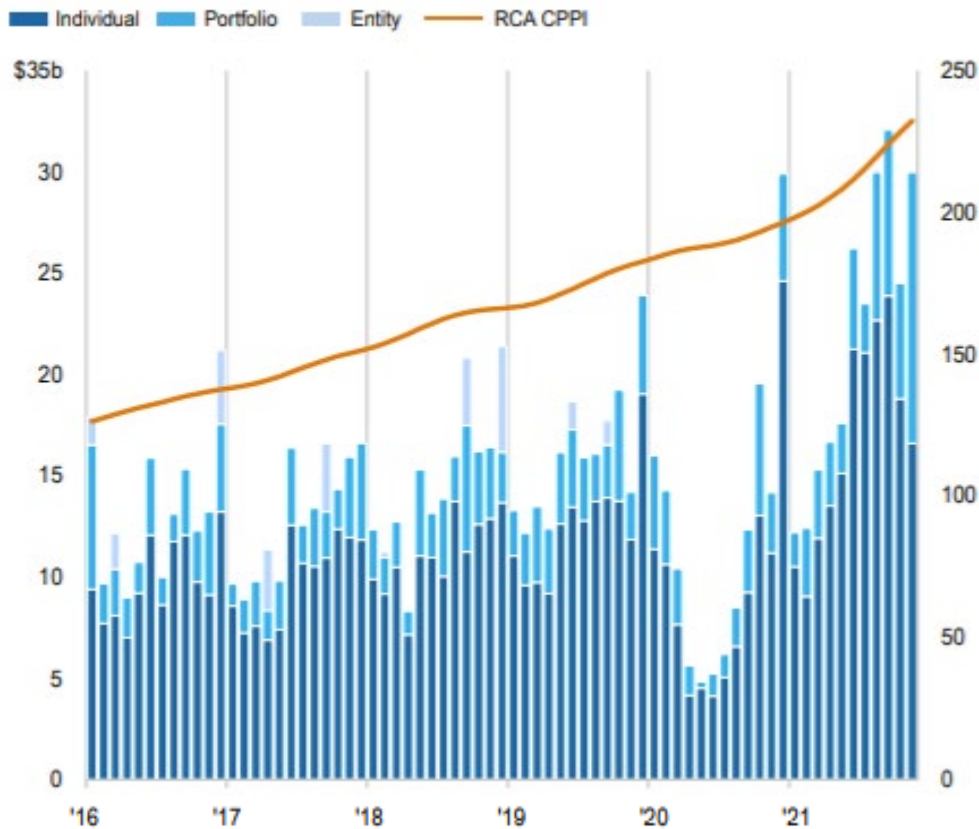
. . . . CoStar industrial absorption is strong with strength expected to continue

NET ABSORPTION, NET DELIVERIES & VACANCY

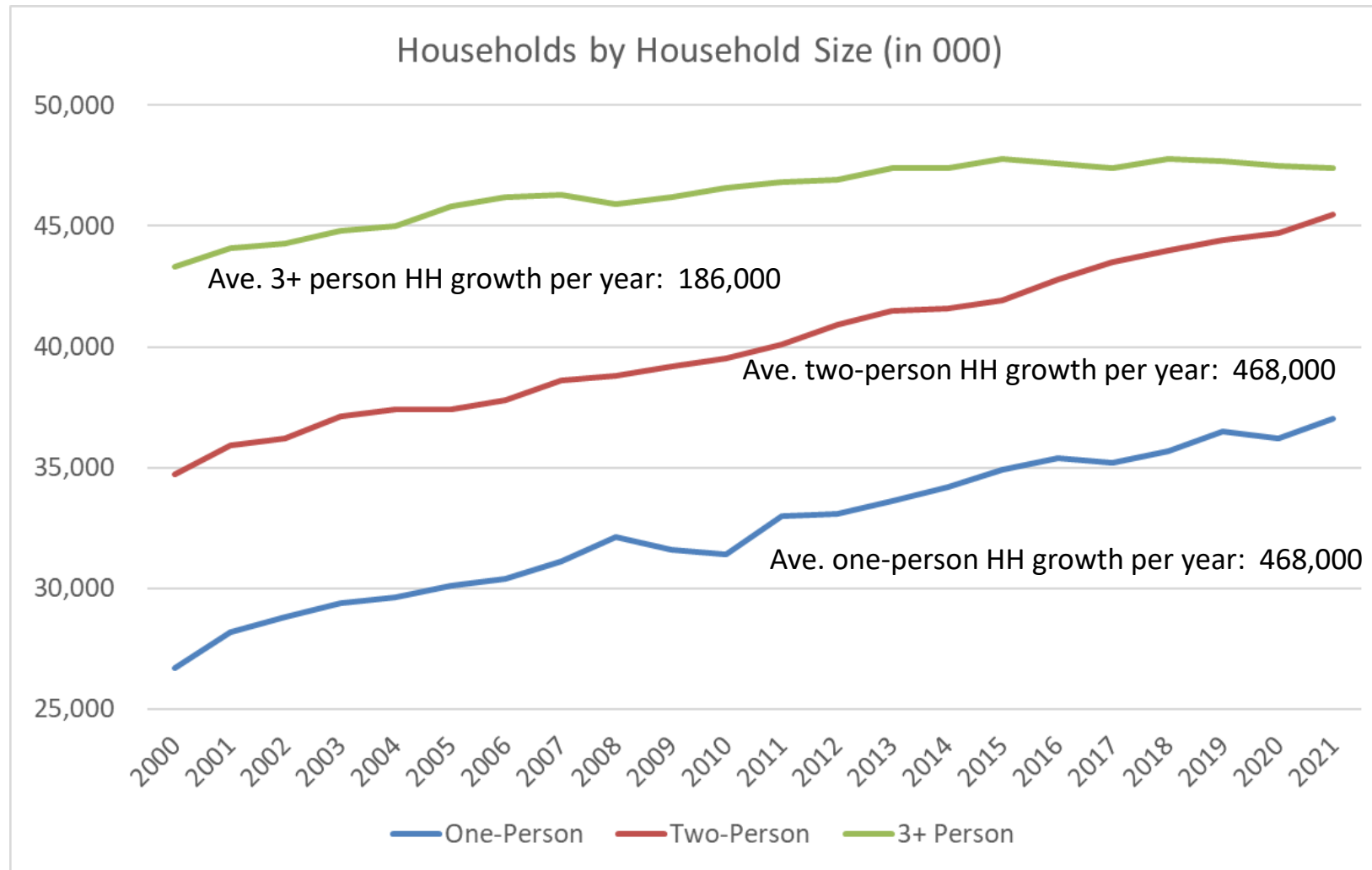


... like industrial, multifamily transaction volumes are way up with declining cap rates ...

Monthly Transaction Volume & Pricing

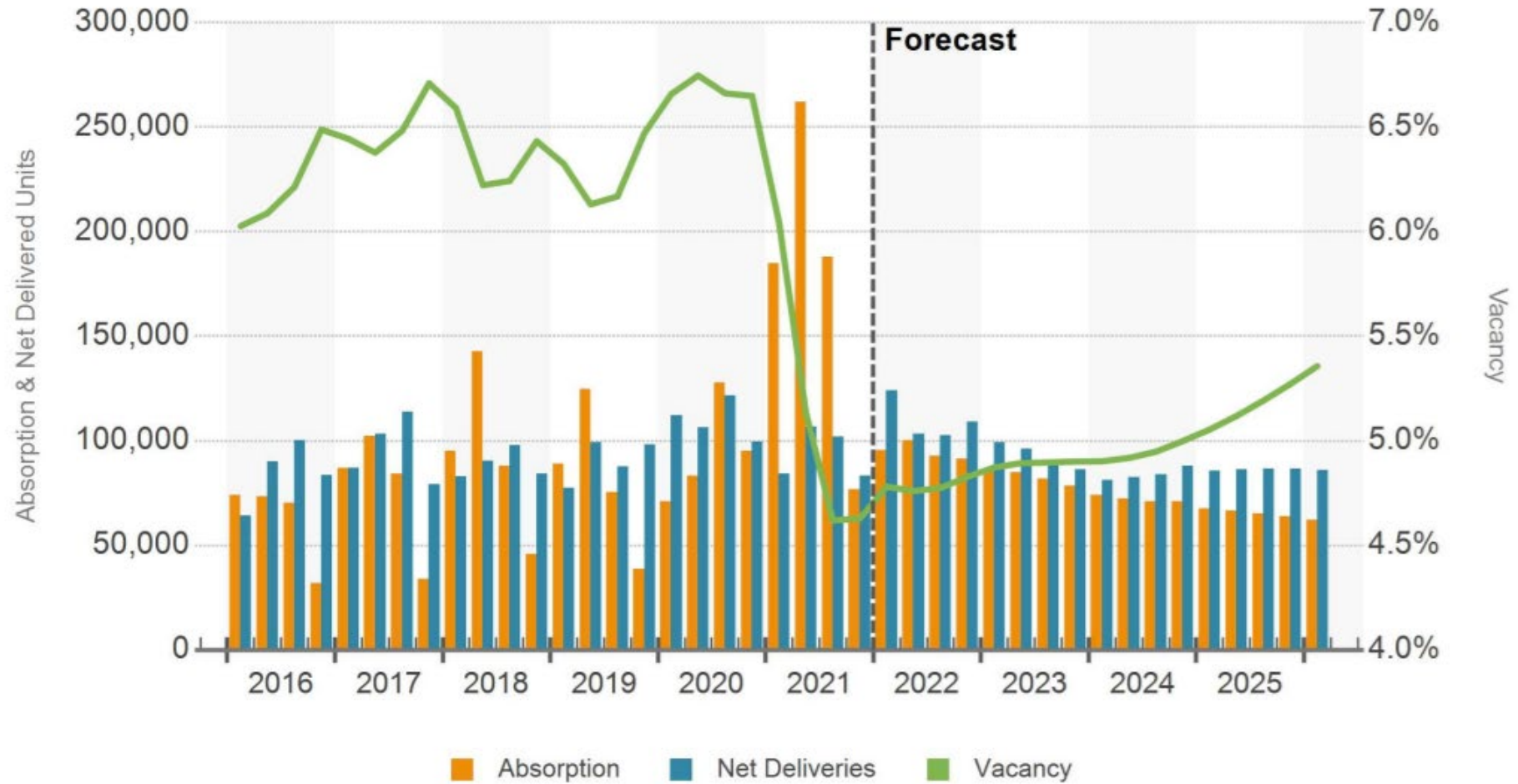


. . . . multifamily absorption is strong with strength expected to continue



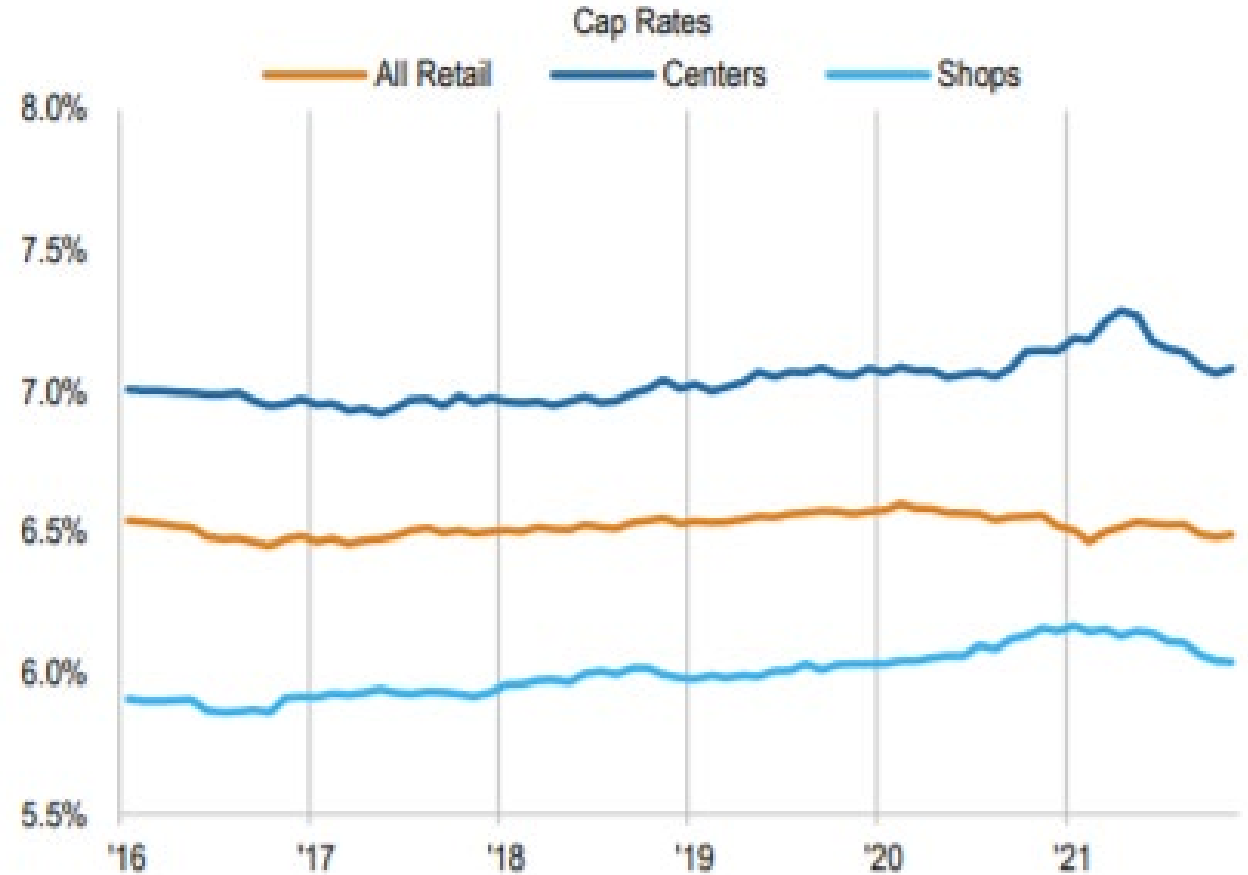
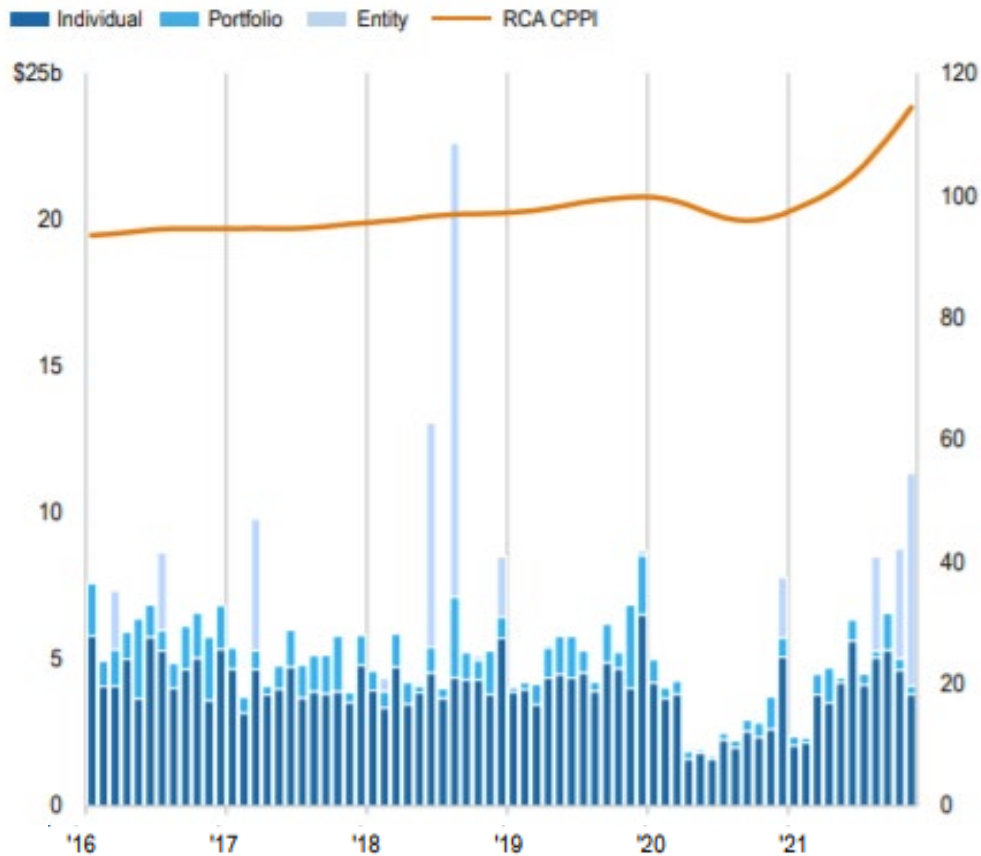
. . . . CoStar multifamily absorption is strong with strength expected to continue

ABSORPTION, NET DELIVERIES & VACANCY

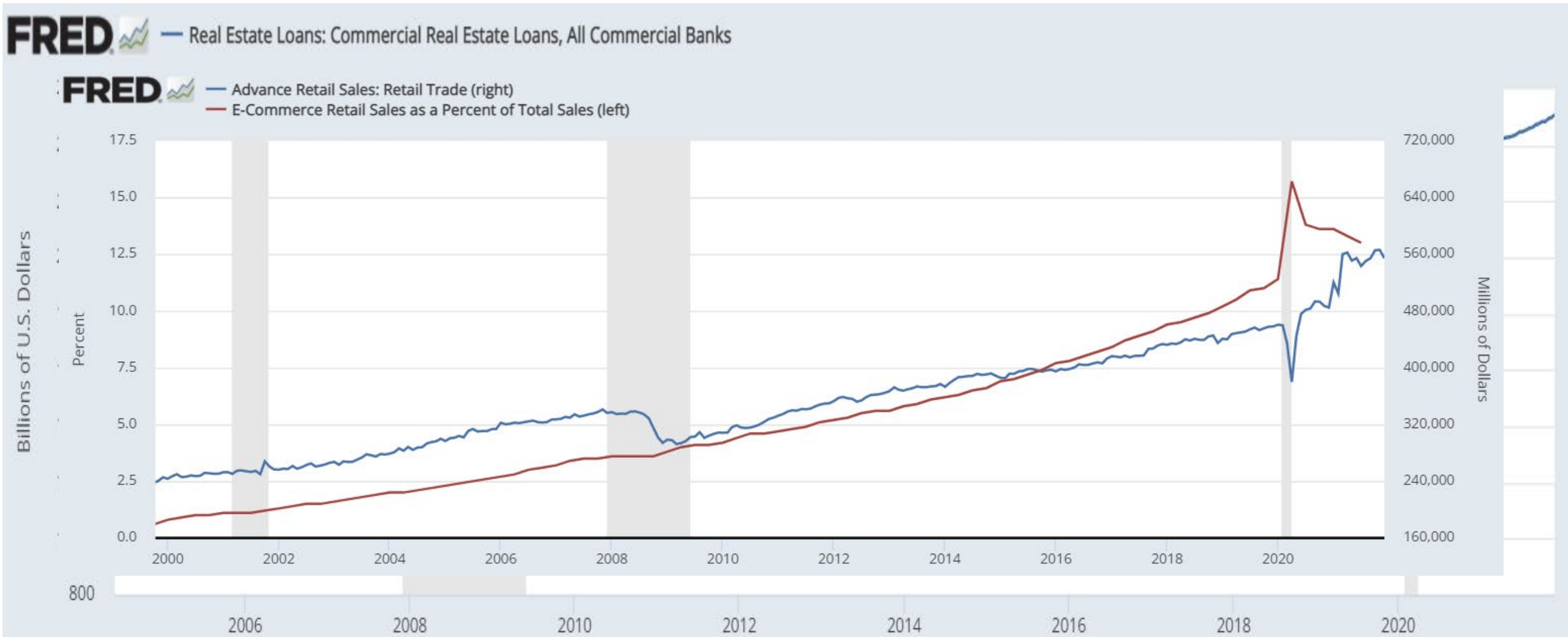


. . . . retail transaction volumes are stable with flat cap rates

Monthly Transaction Volume & Pricing

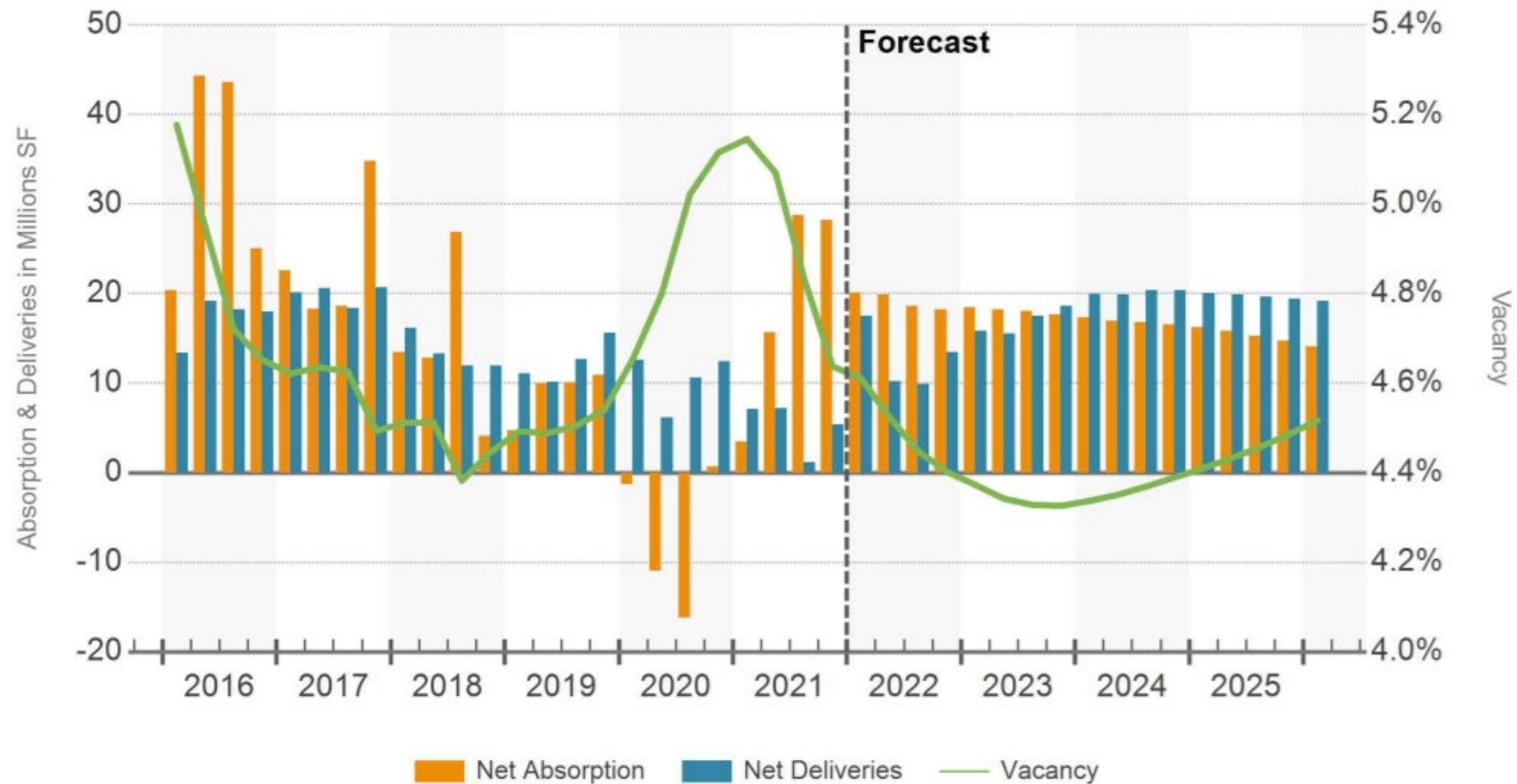


. . . . retail spending jumped with Covid concerns with moderating e-sales



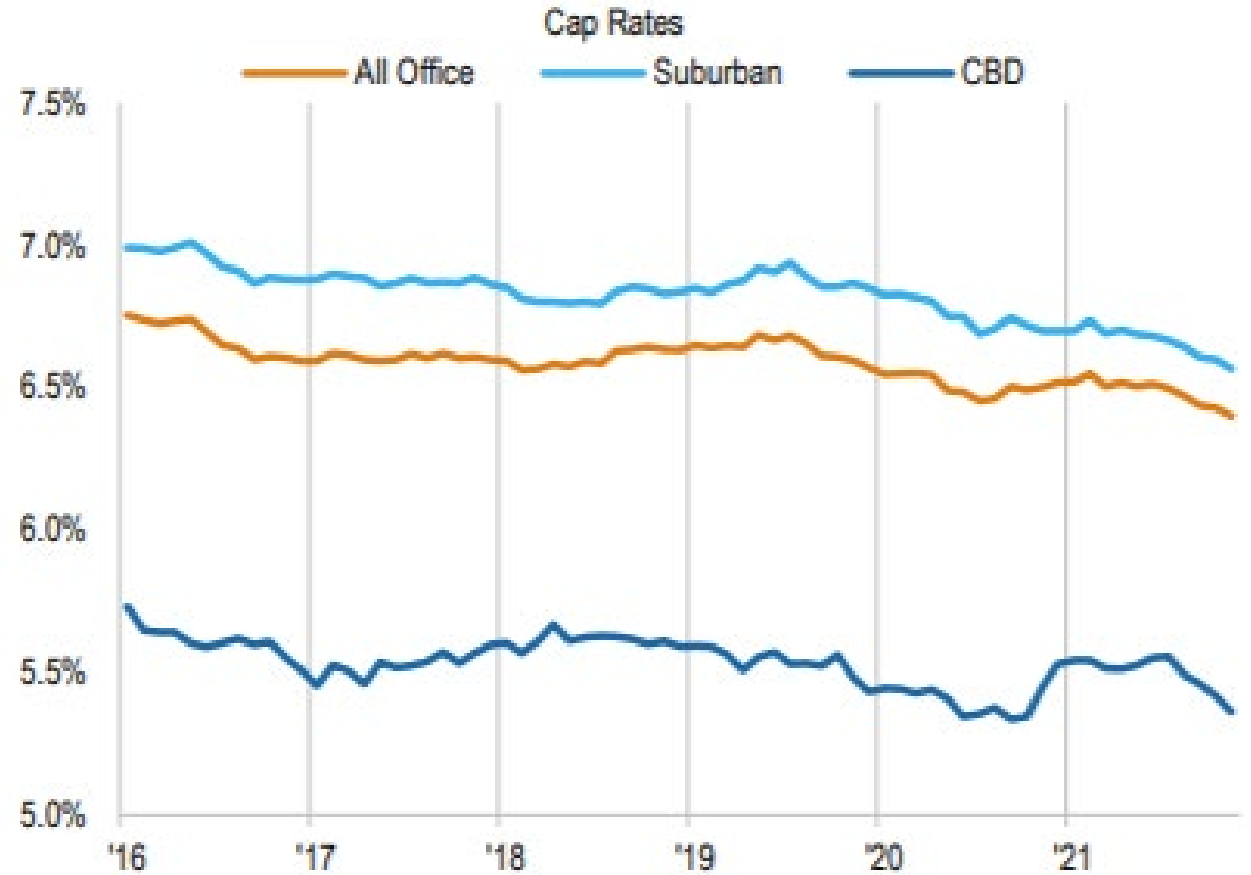
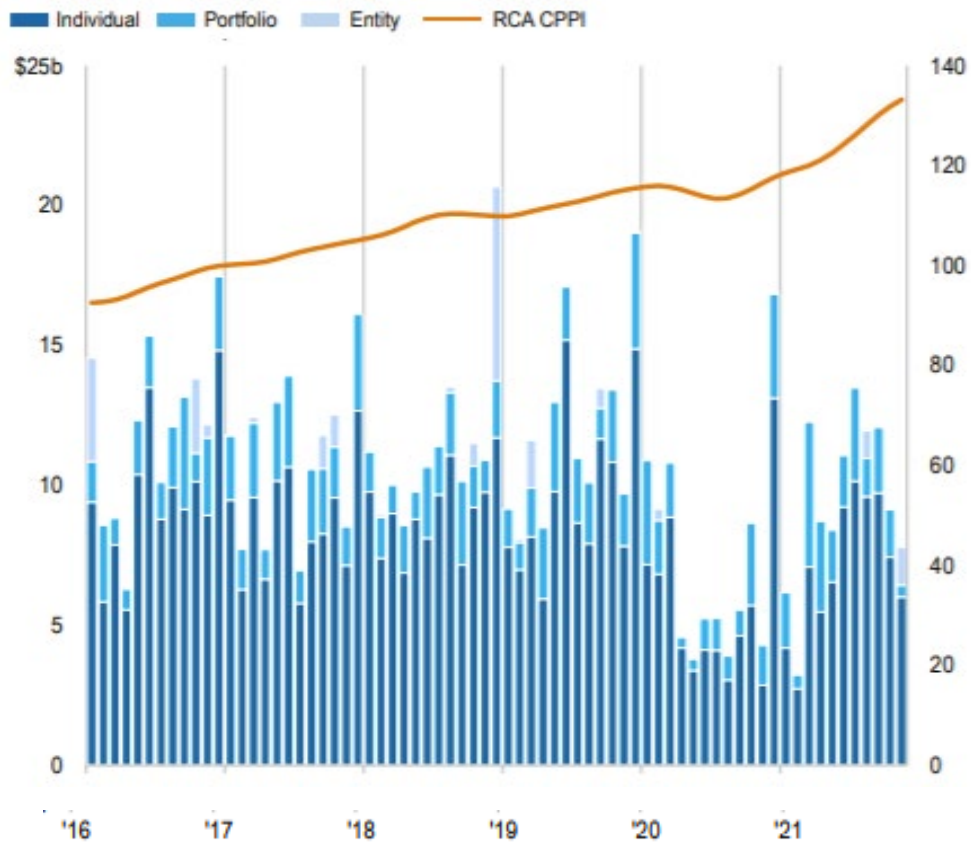
. . . . CoStar retail absorption is strong with strength expected to continue

NET ABSORPTION, NET DELIVERIES & VACANCY



. . . . office sales volume is murky, with cap rates edging lower

Monthly Transaction Volume & Pricing

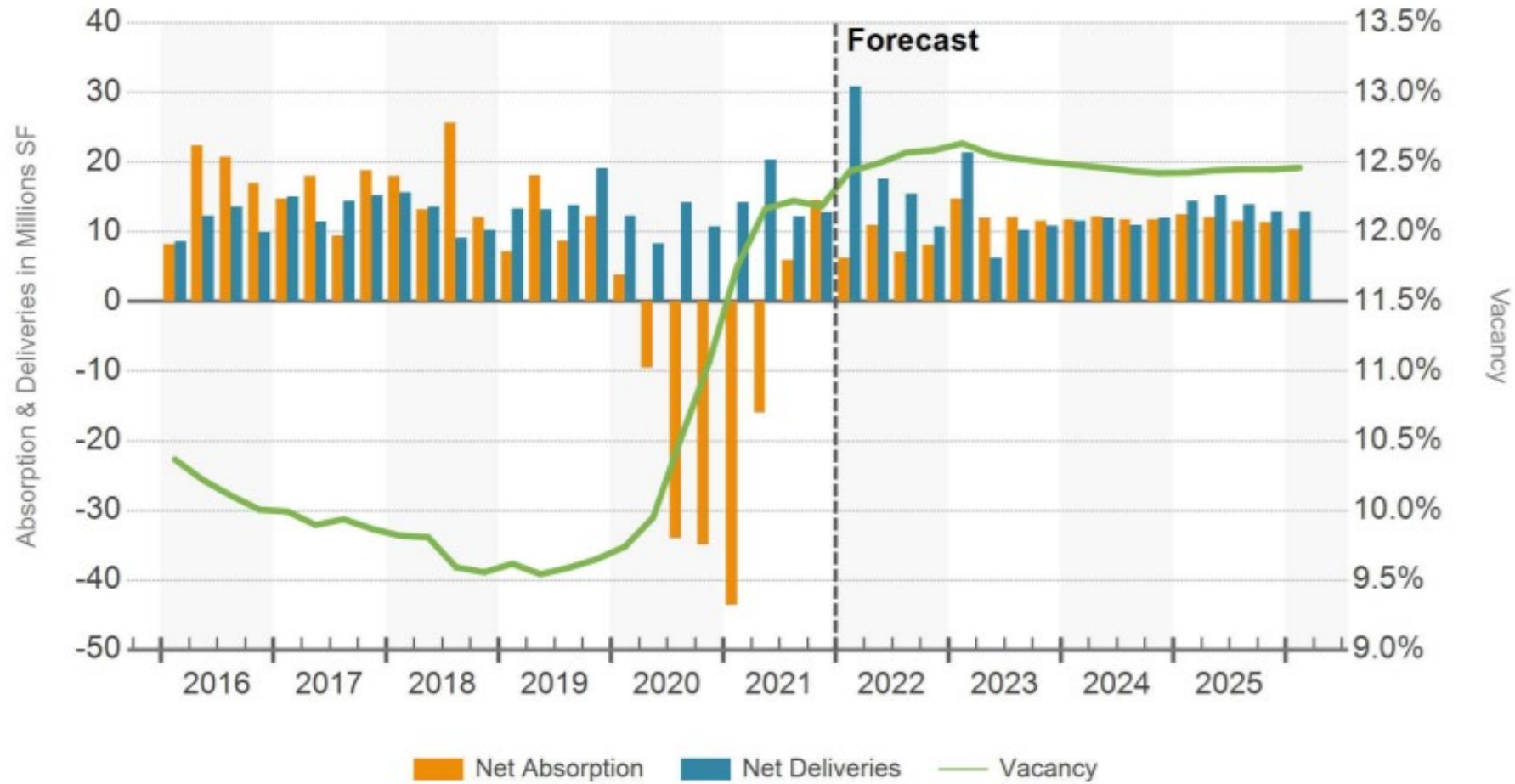


. . . . back to the office or work from home



. . . . CoStar office absorption is strong with strength expected to continue

NET ABSORPTION, NET DELIVERIES & VACANCY



Summary and trends for 2022

Covid determines the timing of economic growth and where consumers spend – goods or services

1. Property Markets – Consumers and Businesses will spend/invest through 2023
 - A. Industrial – distribution outperforms through 2023 into 2024, then a shift to flex space
 - B. Multifamily – will remain solid and largely in balance due to increased construction costs
 - C. Retail – brick and mortar retail will outperform as distribution and return costs eat into profitability
 - D. Office – significant underperform due to limited demand (work from home) and capex costs

2. Capital Markets – Debt and Equity sources are plentiful, but will remain relatively disciplined
 - A. Cap rates will drift higher, marginally higher, with asset prices growing from NOI growth
 - B. Inflation:
 - Higher goods cost push short-term inflation up (4.0-5.0% in 2022 and into 2023)
 - Higher labor costs push medium-term inflation higher (2.5-3.0% in 2024+)
 - C. Rates
 - Inflation will push 10-year UST to 2.5% by year end 2022
 - Risk Premiums will be squeezed as banks have excess capital over long-term averages



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Director, Graaskamp Center for Real Estate
January 2021

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