ValTrends
4Q 2023 Report

Bloom is Off the Rose

Since 1931, the most trusted investment analysis in the commercial real estate industry.

SitusAMC

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Starting in mid-2022 and continuing into 2023, commercial real estate (CRE) has been besieged by a turbulent capital markets environment primarily brought on by the rapid run-up in interest rates. While CRE returns, transactions and prices fell, space market fundamentals for most of the main property types remained relatively resilient. However, as we closed out 2023 and launched into 2024, ***the bloom is off the rose****, especially for property types that performed exceptionally well in 2021 and part of 2022. To be sure, overall CRE performance remains weak. At -7.9%, the NCREIF NPI one-year trailing return was among the worst since the GFC. Overall CRE deal activity, as measured by MSCI Real Assets, also remains tepid at the start of 2024, with just $22.6 billion in volume, the slowest January since 2012. Current valuations for most property segments are on the decline and the pain will likely be felt throughout much of 2024.*

Industrial and apartments, the standouts during the pandemic, are starting to lose their sheen. Values are declining in the broad industrial market, according to SitusAMC, with an estimated 7% to 8% of value at risk in 2024. Rent growth is slowing as demand weakens, absorption cools and vacancies uptick. Though still high by historical standards, fourth quarter warehouse occupancy declined for the fifth consecutive quarter, to the lowest level in almost two years, according to Reis. Net absorption slowed considerably quarter over quarter (QoQ), to the lowest since the global financial crisis (GFC), though it remained positive. Effective rent growth once again decelerated from record levels, growing by just 0.5%, the slowest pace since third quarter 2020 and about 40 bps below the long-term average (LTA).

Apartment demand also weakened in fourth quarter, with occupancy declining to the lowest level since mid-2021, per Reis. Fourth quarter occupancy was 10 bps below the LTA. Net absorption, though positive, was the lowest since the GFC. Effective rents fell by 1.6% in fourth quarter, the worst loss since third quarter 2020. Because of the record high rent growth in 2021 and 2022, rents remain significantly higher than pre-pandemic levels, near 20%. According to SitusAMC, apartment saw its largest value decrease of 2023 in the fourth quarter of around 4.3%, largely driven by the expansion of investment rates. Values continued to decrease into first quarter, albeit at a decelerated pace, with much of the changes coming from cash flow adjustments. Additional value at risk in 2024 may be up to 10%. Negative value allocation is coming from expenses (insurance costs, payroll, taxes, utilities and maintenance), which hits apartment net operating income (NOI) especially hard because the sector does not get reimbursements for expenses. However, one of the greatest components of potential value at risk for apartments is in lease trade-out premiums as contract rents begin to soften and short-term concessions burn off.

The bloom has been off the rose for the office segment for most of the pandemic. In fourth quarter, office fundamentals continued to deteriorate, with occupancy dropping 40 bps QoQ to a record low, per Reis. Net absorption was once again substantially negative and among the weakest since the GFC. Weak demand has led to declining effective rents for the second consecutive quarter. Completions increased by 60% QoQ and remain similar to post-GFC lows. According to SitusAMC, office values continue to deteriorate with an estimated 15% value at risk in 2024.

Retail may be the best of the worst. Though returns were negative for the third consecutive quarter, fundamentals remain stable, with the occupancy rate unchanged for the fourth consecutive quarter, according to Reis. Although that is the highest level since the beginning of the pandemic, occupancy was still 120 bps below the LTA. Net absorption turned negative for the first time since the end of 2020, though effective rents were able to eke out a small gain. According to SitusAMC, retail is experiencing mostly positive lease trade-outs and a pickup in NOI growth. Still, retail is looking at about 5% reduction in value in 2024.

01

CAPITAL MARKET VALTRENDS

Capital Markets Beleaguered by High Interest Rates and Uncertainty

Economy & Financial Markets

GDP increased at a 3.2% annual rate in fourth quarter (second estimate), decelerating from third quarter's 4.9% rate, but among the strongest in two years. Fourth quarter's growth was primarily attributable to increases in consumer spending, exports, and state and local government expenditures.

Following a cooling in October and November, the labor market regained steam in December and early 2024. The economy added 275,000 jobs in February, the largest increase since May 2023. However, the unemployment rate inched up 20 bps from January to 3.9%, the highest level in two years. The labor force participation rate remained at 62.5% for the third consecutive month in February, about 50 bps lower than pre-pandemic levels. Wage growth has been relatively stable since October near 4.3%. February wage growth was among the slowest since July 2021, a positive sign for further reductions in inflation, but is still over 100 bps above the LTA.

While CPI inflation came in hotter than expected in February, current inflation rates are among the slowest since early- to mid-2021. The consumer price index (CPI) grew 10 bps to 3.2% in February after a 20

CRE & Investment Alternatives

	2023[6]	3-Year Trailing	5-Year Trailing	10-Year Trailing	15-Year Trailing
NPI[1]	-7.9%	4.6%	4.3%	6.8%	6.4%
NFI-ODCE[1]	-12.7%	4.0%	3.3%	6.3%	5.1%
NAREIT Index (All Equity REITs)[2]	11.4%	5.7%	7.6%	8.0%	10.9%
Consumer Price Index[3]	3.2%	5.7%	4.0%	2.8%	2.5%
Dow Jones Industrial Average[2]	16.2%	9.4%	12.5%	11.1%	12.9%
Nasdaq Composite[4]	43.4%	5.2%	17.7%	13.6%	16.2%
NYSE Composite[4]	11.0%	5.1%	8.2%	4.9%	7.4%
S&P 500[2]	26.3%	10.0%	15.7%	12.0%	14.0%

	4Q 2023	4Q 2022	4Q 2020	4Q 2018	4Q 2013	4Q 2008
10-Year Treasury Bond[5]	4.4%	3.8%	0.9%	3.0%	2.7%	3.3%

[1]NCREIF NPI is a property-level (unleveraged) total return index, gross of fees; NCREIF NFI-ODCE is a fund-level (leveraged equity) total return index, net of fees.
[2]Based on total return index, and includes the dividend yield.
[3]Based on the published data from the Bureau of Labor Statistics (seasonally adjusted).
[4]Based on price index, and does not include the dividend yield.
[5]Based on average quarterly T-bond rates.
[6]Averages are not compounded annually except for CPI and NAREIT.
Sources BLS, Federal Reserve Board, S&P, Dow Jones, NCREIF, NAREIT, compiled by SitusAMC Data & Analytics, 4Q 2023.

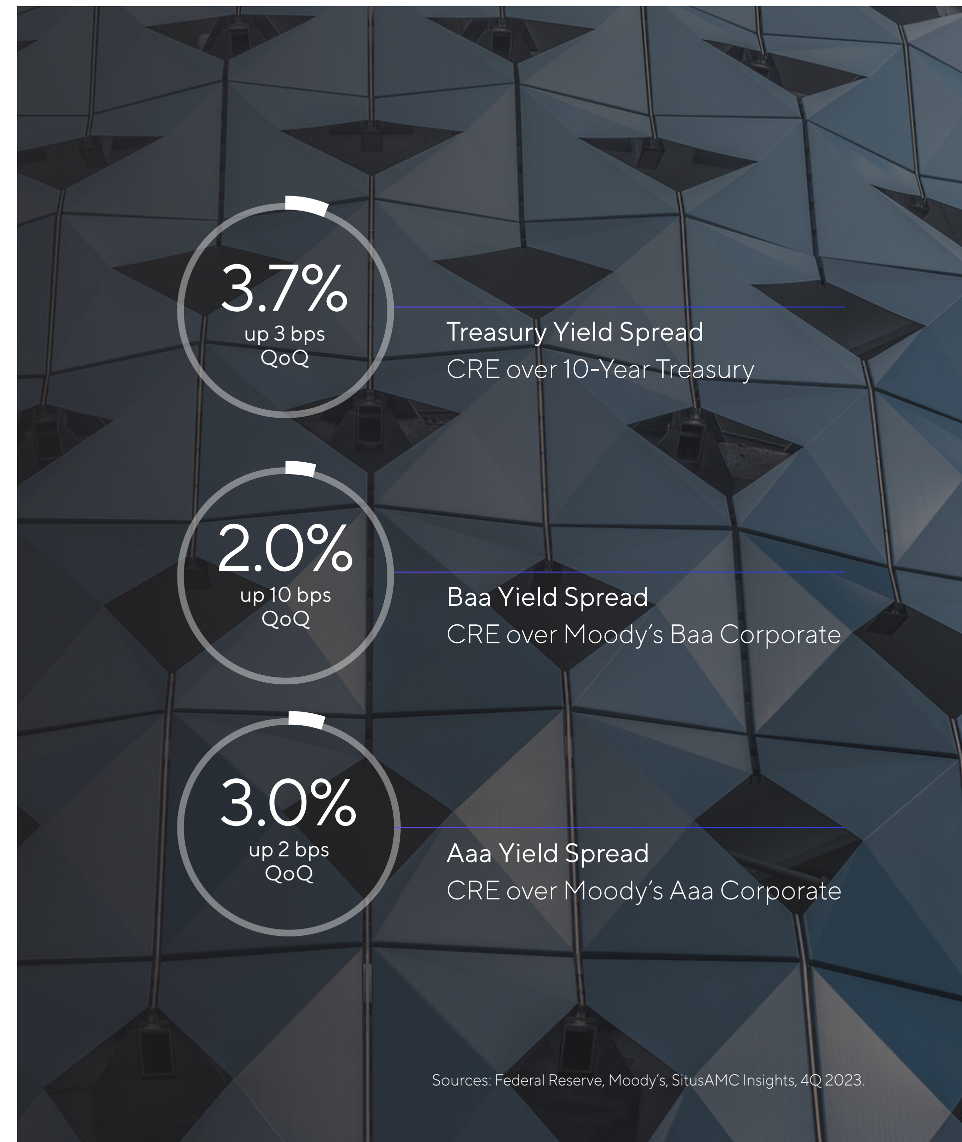
bps decline in January. Core CPI, which excludes food and energy, was 3.8% in February, slowing 10 bps MoM. Core personal consumption expenditures (PCE), the Fed's preferred inflation measure, has decelerated steadily since May 2023 to 2.8% in January.

Following a peak of nearly 5% in October 2023, the 10-year Treasury fell steadily, reaching 3.9% by the end of December. Since the beginning of 2024, the 10-year rate rose nearly 40 bps through the end of February before declining about 20 bps by mid-March. The 10-year rate has generally hovered in the 4.0% to 4.25% in early 2024 and reached 4.3% by mid-March. The Fed kept interest rates stable during its January meeting. Fed fund futures indicate that markets are expecting a rate cut in June, even as Jerome Powell remains cautious given the strong labor market and elevated inflation.

Spreads between RERC real estate yields and the 10-year Treasury expanded slightly in fourth quarter, with the increase in real estate yields outpacing growth in the Treasury rate. Still, fourth quarter spreads were among the lowest since the GFC.

The fourth quarter CRE yield over 10-year Treasury spread was almost 200 bps below the LTA. Fourth quarter real estate yield spreads over Moody's Baa and Moody's Aaa were about 115 bps and 120 bps below the LTA, respectively.

As 2024 ramps up, SitusAMC's securitization team is seeing increasing deal volume, specifically in the conduit space. We are seeing some SASB offerings, but they are not as prevalent as conduits and we have started getting more inquiries about CLOs.



CRE & Investment Alternatives

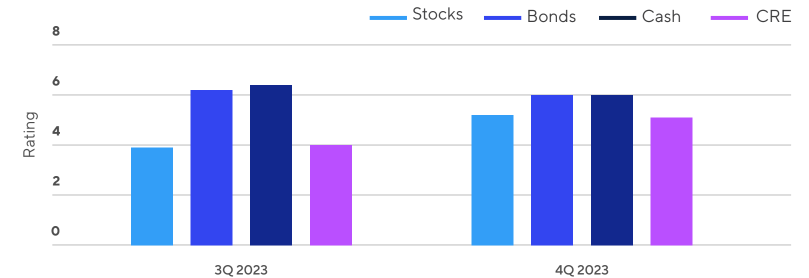
With all major stock indexes surging since late 2023, investor optimism for stocks jumped in fourth quarter to the highest level since mid-2021 and well above the long-term average. Investors in our quarterly survey anticipate that capital will flow into stocks as recession fears and interest rates drop.

The rating for CRE also increased QoQ to the highest level since mid-2022 when the Fed began its aggressive rate hike policy. Despite the increase, the rating for CRE is well below the long-term average and was the lowest rating among the investment alternatives. Investors are optimistic about interest rate cuts this year, but are concerned that values have further to fall.

The ratings for bonds and cash declined for the second consecutive quarter, falling from record highs. Still, bonds and cash were tied for the highest-ranked investment alternative and are well above their LTAs. Investors from our survey are still wary of capital market uncertainty and prefer the safety of bonds and the liquidity of cash.

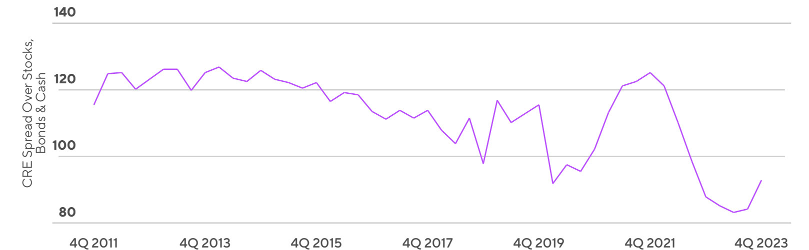
> "Stocks are likely to increase with announced interest rate cuts for 2024, CRE is likely to follow."
>
> - MIDWEST REGION INVESTOR

Ratings of Investment Alternatives



Ratings are based on a scale of 1 to 10, with 10 being excellent.
Sources: RERC, SitusAMC Insights, 4Q 2023.

CRE Attractiveness Index[1]



[1]The RERC Attractiveness Index shows CRE investors' changing preferences for CRE over the traditional asset classes. The baseline of 100 indicates that investors feel traditional assets and cash, on average, are as attractive as CRE. Sources: RERC, SitusAMC Insights, 4Q 2023.

Availability & Discipline of Capital

The availability of capital grew and underwriting standards loosened in fourth quarter, according to investors from our survey. It was the third consecutive quarter of improvement in capital availability, though the rating is still among the lowest since the GFC. Underwriting standards remained exceptionally tight in fourth quarter, near GFC levels, despite the rating decreasing for two consecutive quarters.

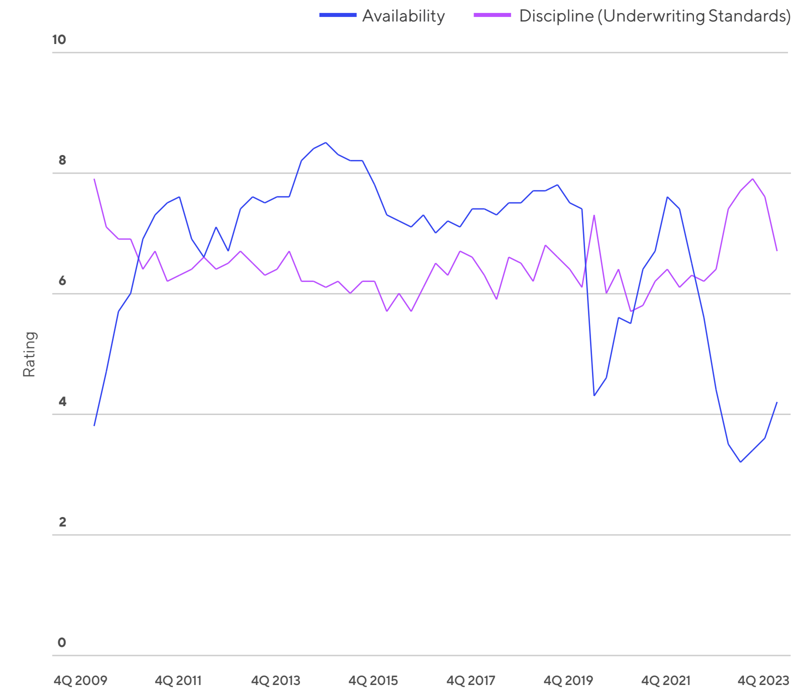
Both debt and equity capital availability ratings increased QoQ, reaching the highest levels since mid-2022. Debt capital was rated as more plentiful than equity capital for the first time since the pandemic began. Underwriting loosened QoQ for both debt and equity, but debt underwriting remains more conservative than equity as it has since early 2022.

Investors from our survey report that, in many cases, the equity requirements in a leverage position need to be commensurate with yield or returns enough to satisfy the equity investment.

The SitusAMC advisory team cautions that there are many smaller banks with a heavy CRE portion on their balance sheets and not enough reserves. These banks may not have the wherewithal to increase the reserves to the level that is needed. Federal Reserve Chair

> "Debt is available, but the price is too high."
>
> - MIDWEST REGION INVESTOR

Historical Availability & Discipline of Capital – Equity & Debt Combined

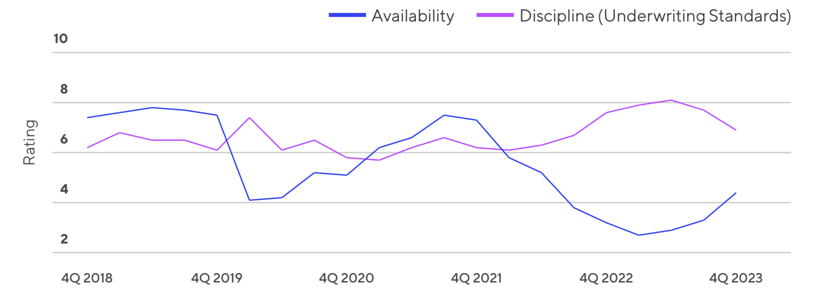


Ratings are based on scale of 1 to 10, with 10 being excellent.
Sources: RERC, SitusAMC Insights, 4Q 2023.

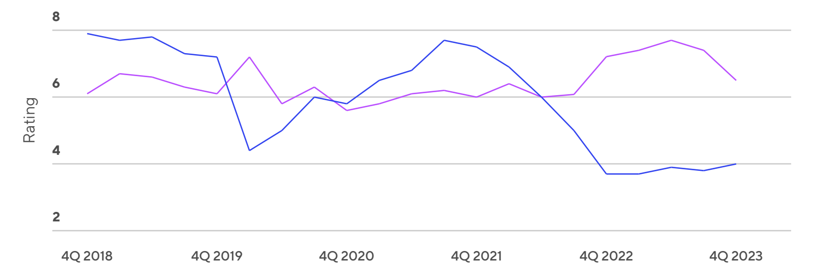
Jerome Powell agrees, stating that bad CRE loans will likely cause some harm to small- and medium-sized banks, but does not pose a risk to the overall banking system.

SitusAMC advisory is also seeing an uptick in sizing volume and our underwriting pipeline, which is encouraging. Deals exist, but are taking much longer to pass through credit committees and require more stringent modeling and analysis to better understand the risk profile. During the due diligence process, the cash flow of the property, market assumptions, and appraisal information often do not meet the expectations from when the deal was originally signed and the term sheet executed.

Historical Availability & Discipline of Capital – Debt



Historical Availability & Discipline of Capital – Equity



Ratings are based on scale of 1 to 10, with 10 being excellent.
Sources: RERC, SitusAMC Insights, 4Q 2023.

CRE Returns, Volume & Pricing

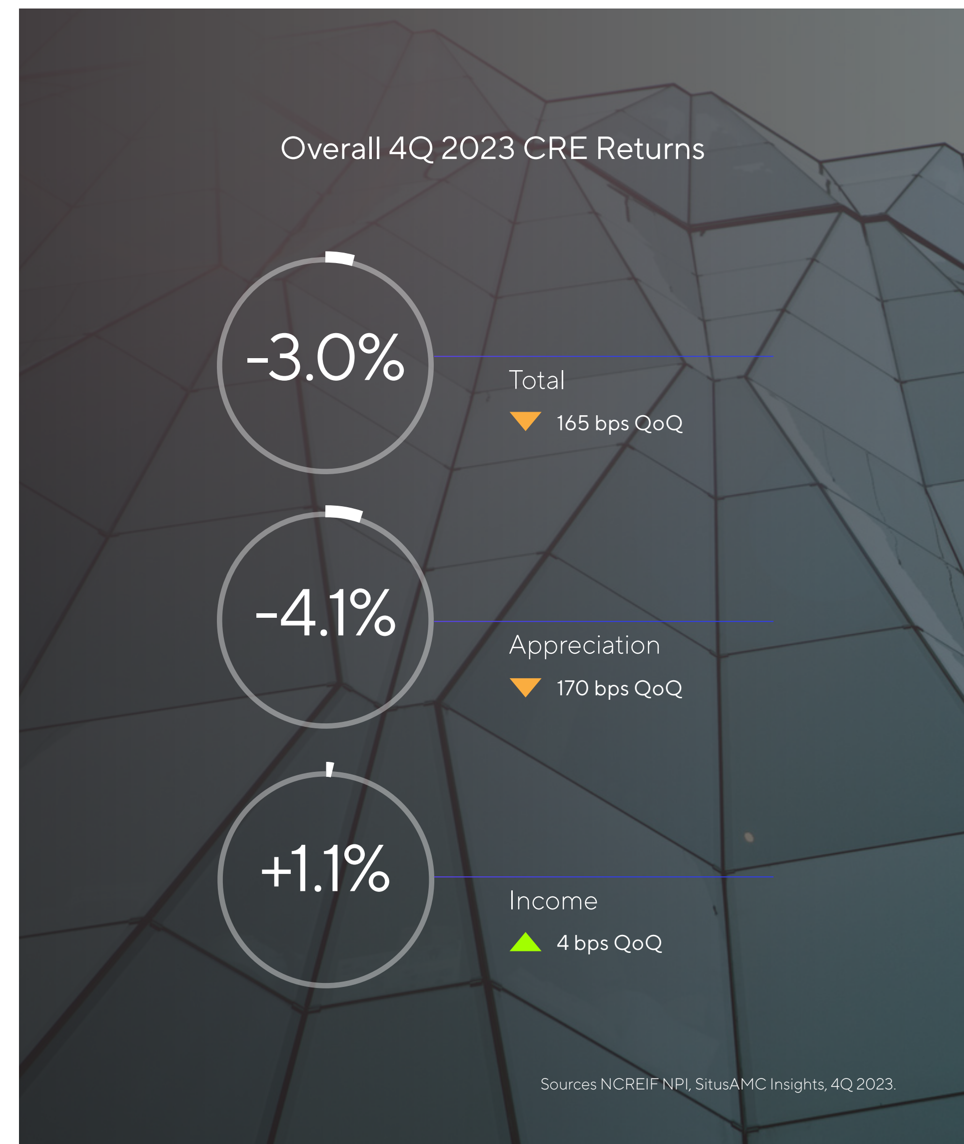
Returns

CRE performance tumbled in fourth quarter, with NCREIF NPI overall CRE returns down 170 bps QoQ. It was the worst quarter for CRE since fourth quarter 2022 and one of the worst since the GFC. One-year trailing returns were -7.9%, also among the worst since the GFC.

Office returns tumbled 170 bps QoQ to -5.4%, according to NCREIF. It was the second-worst quarterly performance since the GFC, trailing only the -5.8% seen in second quarter 2023. Office has posted the lowest total returns of all segments in the NPI for two years. However, income returns increased slightly to the highest level in over nine years. One-year trailing returns were abysmal at -17.6%, approaching GFC-era lows.

At -2.3%, industrial had the second-worst quarterly performance since the GFC, according to NCREIF. Fourth-quarter returns have fallen a massive 1560 bps since their peak in late 2021. One-year trailing returns were -4.1%, among the worst since the GFC.

Retail returns dropped 100 bps QoQ to -1.1%, per NCREIF. It was the third straight quarter of negative returns. Retail returns were down 340 bps from their most recent peak in first quarter 2022. Still, income returns were strong at the highest since the end of 2014.



Falling 160 bps QoQ, NPI total apartment returns were negative for the fifth consecutive quarter at -3.0%; it was the lowest quarterly return since fourth quarter 2022. Returns were 500 bps below the LTA. Returns have fallen steeply since their pandemic peak at the end of 2021, down 980 bps. However, income returns remain relatively strong at the highest level since the onset of the pandemic. One-year trailing returns were -7.3%, among the worst since the GFC.

Hotel had the strongest returns among the main property types at 1.8% and was the only segment to earn a positive quarterly return, per NCREIF. Still, hotel returns were the lowest since first quarter 2022. Income returns remained relatively healthy, about 20 bps higher than the LTA. One-year trailing returns were relatively strong at 10.3%, among the highest since 2015.

Volume

Overall CRE deal activity, as measured by MSCI Real Assets, was off to a rocky start in 2024, with just $22.6 billion in volume, a 41% decline MoM. It was the slowest January in 12 years. January's deal activity was over 88% lower than its peak in December 2021 and was 44% below the LTA. Overall CRE deal volume in January was more than double the monthly average during the GFC, however. Annual deal volume totaled $378 billion in 2023, a 51% decline YoY and the lowest annual rate since 2012.

Apartments garnered the most interest from investors in 2023, with transactions accounting for nearly one-third of total volume. However, allocations to apartment were the lowest since 2018, though four percentage points above the LTA. Industrial comprised the next largest share of total volume at nearly 24%. Interestingly, 2023 allocations were higher than in 2021 and 2022 when industrial deal activity was at record levels. Industrial allocations were also greater than the long-term average by almost 10 percentage points. Office allocations plummeted to about 14% in 2023; it was the lowest percentage in history. Retail allocations increased in 2023 to over 15%, the highest level since 2015. Hotel allocations also grew in 2023 to 7%, the highest level since 2018.

Among the property types, retail was the most active with deal volume surging 85% MoM to $7.9 billion. It was the highest monthly level in almost a year and the best January since 2015. Retail was the only segment with a monthly increase in activity. January's volume was also strong on a historical basis, up 39% from The LTA and well over quadruple the monthly deal activity average during the GFC. Retail volume was down 20% in January from its February 2023 peak. Annual retail deal volume in 2023 was about $58 billion, down 37% YoY to the lowest level since 2020.

Given the structural changes occurring in the segment, it was unsurprising that office experienced the worst monthly decline among the property types, decreasing by 63% to $2.9 billion. It was the slowest January since the GFC. Office volume has fallen 80% from its peak in June 2022 and is almost one-third lower than its LTA. Office also had the weakest annual volume in 2023 since 2010, with just $52 billion transacting.

Apartment transactions were off to a paltry start in 2024, down 59% MoM to just $4.5 billion. January was the weakest start to a year since 2011. While apartment volume was about three-fourths higher than the average during the GFC, January's level was 88% below the most recent peak in June 2023 and less than half its LTA. Annual deal activity was $119.6 billion in 2023, the slowest year since 2014.

Industrial volume declined 42% MoM in January, marking the slowest start to the year since 2014. Deal activity has slowed 87% since the record volume seen in December 2021 and was 6.7% lower than the LTA. Still, January's volume was more than three times the average level during the GFC. Annual transaction activity in 2023 was just over $90 billion in 2023, the lowest level since 2017.

Hotel was off to a poor start in 2024; volume fell 67% MoM in January, the slowest start to a year since 2012. Volume has fallen 80% since the Fed began its aggressive rate hike policy in June 2022 and January's level was less than half the LTA. Hotel volume remains elevated compared to GFC levels, by about 40%. On an annual basis, hotel transacted over $26.5 billion, a 46% decline YoY and the lowest since the beginning of the pandemic.

Pricing

As interest rates remain historically elevated, commercial property prices, as measured by MSCI Real Assets' National All-Property CPPI, were down nearly 6% at the end of 2023 from the year prior. Unsurprisingly, office experienced the most depreciation among the property types in 2023, with prices falling over 16%. Apartment prices fell almost 8.5% in 2023 and retail prices declined 5.5%. Industrial was the only segment to eke out a price gain in 2023 of just 0.5%.

Prices continued their descent in 2024 for overall CRE, office and apartment. Monthly declines for these sectors were 0.1%, 0.4% and 0.8%, respectively. Office has seen monthly price depreciation for 19 consecutive quarters, though the pace has slowed since last October. The rate of monthly price declines has been relatively stable for apartment and the overall CRE market for the past six months. Retail and industrial prices eked out small gains at the beginning of 2024, up 0.1% and 0.2%, respectively. January marked the first month of appreciation for retail since the Fed began its aggressive rate hike policy in mid-2022. Industrial has enjoyed monthly appreciation for seven straight quarters, though the pace of growth has slowed since October.

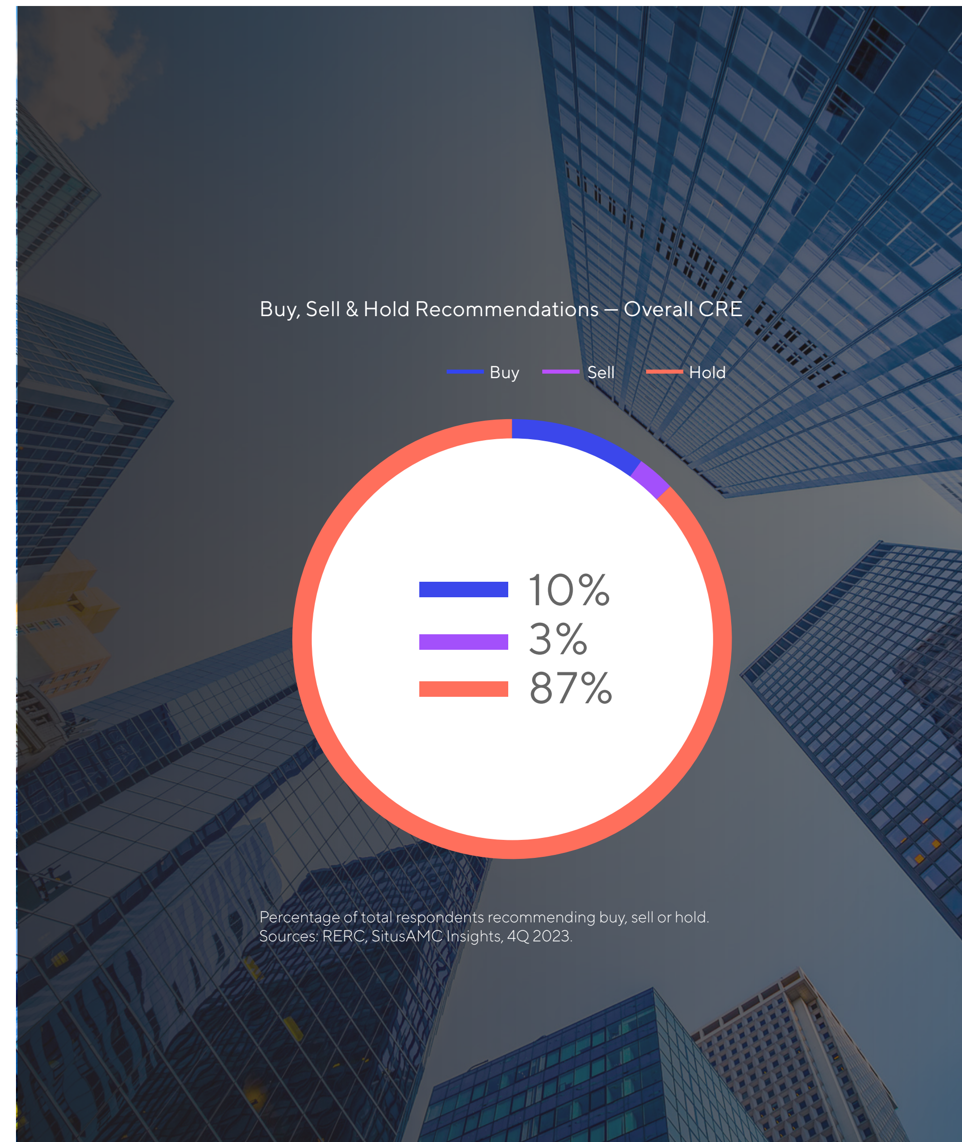
Prices were down substantially in January from their 2022 peaks for overall CRE and all segments except industrial. Office prices have fallen the most from their peak, down 20%, followed by apartment and retail at 16% and 8%, respectively. Overall CRE prices were down 12% from their peak.

RERC Buy, Sell or Hold

Citing ongoing uncertainty with the economy, interest rates and geopolitical events, investors in our quarterly survey recommended a hold position in fourth quarter. The recommendation to hold declined by 8 percentage points to 87%; it was the tenth consecutive quarter in which Investors preferred to hold. Despite the decline, the hold strategy was almost double the level seen during the GFC. The recommendation to buy increased from 5% last quarter to 10% in fourth quarter and the recommendation to sell increased from 0% to 3%. three percentage points. Ratings for buy and sell remained near record lows at 12 percentage points and 11 percentage points below GFC levels, respectively.

Investors recommended holding for the overwhelming majority of property types: warehouse, flex, regional mall, power center, neighborhood/community centers and hotel. Investors were bullish on apartments; it was the only main property type with a buy rating. CBD and suburban office as well as R&D earned a sell rating.

> "With more time passing, markets are adjusting to the lower valuations."
>
> -INSTITUTIONAL INVESTOR



Percentage of total respondents recommending buy, sell or hold.
Sources: RERC, SitusAMC Insights, 4Q 2023.

02

VALTRENDS BY PROPERTY TYPE

Retail and Hotel Steady to Up While Other Segments Lag

RERC Perceived Return Relative to Risk

Ratings for overall CRE improved in fourth quarter, with institutional investors from our quarterly survey indicating risk and return are roughly in equilibrium. Office ranked the worst in perceived relative risk and apartment ranked the best.

Ratings for the office segment improved QoQ, albeit from record lows. The segment is still seen as exceptionally risky relative to return, however, and well below the LTA. Investors continue to cite the work-from-home trend as the biggest driver of uncertainty, causing occupancy issues and tenants downsizing on lease rollovers.

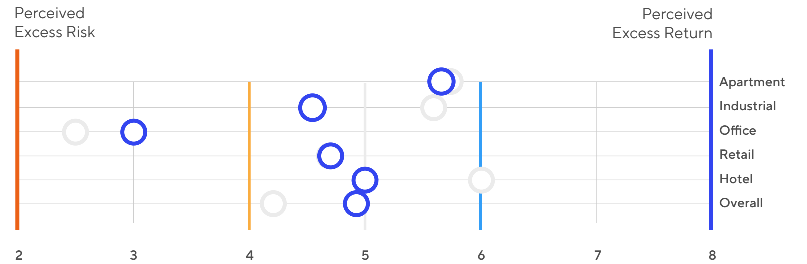
Industrial experienced a significant decline in ratings in fourth quarter, with risk now outweighing returns.

The current quarter's ratings are substantially below the LTA and have been on a general decline since the Fed started its aggressive rate increases in second quarter of 2022. Investors are starting to see more local resistance and NIMBYism to construction at highway intersections in exurban areas making new construction difficult.

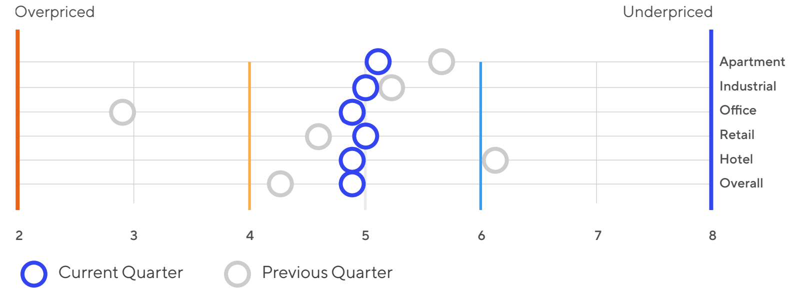
Though experiencing a small decline in ratings QoQ, apartment was the only segment perceived as having higher returns relative to risk Hotel ratings also fell QoQ, with returns roughly aligned with the risk profile. Both segments were rated significantly above their LTA.

Retail ratings remained steady in fourth quarter, among the highest since the pandemic began and on par with the LTA.

RERC Perceived Return Relative to Risk



RERC Relative Value Sentiment



Current Quarter Previous Quarter

Ratings are based on a scale of 1 to 10, with 10 indicating that return far exceeds risk or value far exceeds price. Sources: RERC, SitusAMC Insights, 4Q 2023.

RERC Relative Value Sentiment

Overall CRE and all the property types were seen as relatively fairly priced in the fourth quarter; it was the first time since 2020 that CRE was not considered overpriced. Relative value sentiment improved QoQ for overall CRE, with quarterly increases for retail and, surprisingly, office. Quarterly ratings for industrial, retail and hotel declined.

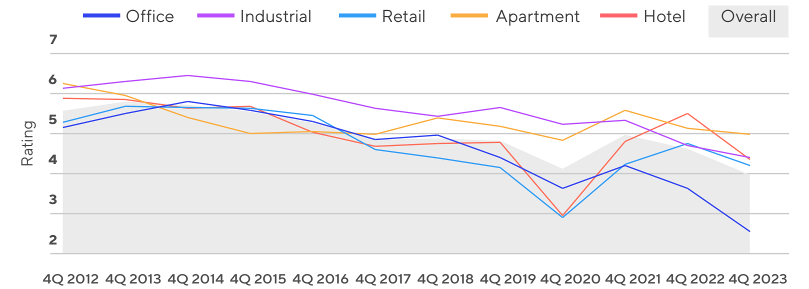
Fourth quarter office ratings were the highest in over two years and above the LTA. With values down substantially over the past year and several notes coming due, which the owner has no means of satisfying, some investors believe that there are opportunities for discount purchase of assets.

Following an upward blip in ratings in the third quarter, hotel ratings declined to near the LTA. According to investors from our quarterly survey, prospects for further value increases may be intact, if the property has already recovered. Lodging properties that remain troubled will likely not be a good investment.

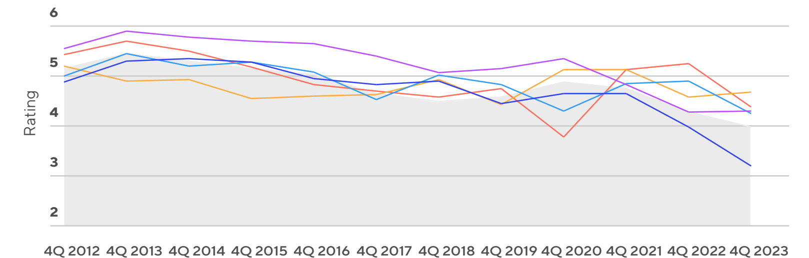
Despite a slight decline QoQ, apartment edged out the other property segments for the highest rating, citing that potential homebuyers are being priced out of the market and will remain renters. Fourth quarter's rating was significantly higher than the LTA.

Retail experienced a substantial increase in ratings QoQ; the rating was well above the LTA. Investors indicate that retail prices are supported by values. Investors note that fundamentals remain steady with excess supply being absorbed and little in the way of new product outside build-to-suit.

RERC Perceived Return Relative to Risk — Average Annual Ratings



RERC Relative Value Sentiment — Average Annual Ratings



Ratings are based on a scale of 1 to 10, with 10 indicating that return far exceeds risk or value far exceeds price. Data represent four quarter moving averages. Sources: RERC, SitusAMC Insights, 4Q 2023.

SitusAMC Office Insights

Office fundamentals continue to deteriorate, with occupancy dropping 40 bps QoQ to a record low, per Reis. Net absorption was once again substantially negative and among the weakest since the GFC. Weak demand has led to declining effective rent for the second consecutive quarter, though rents were 1.1% above pre-pandemic levels. Completions increased by 60% QoQ, though remain similar to post-GFC lows.

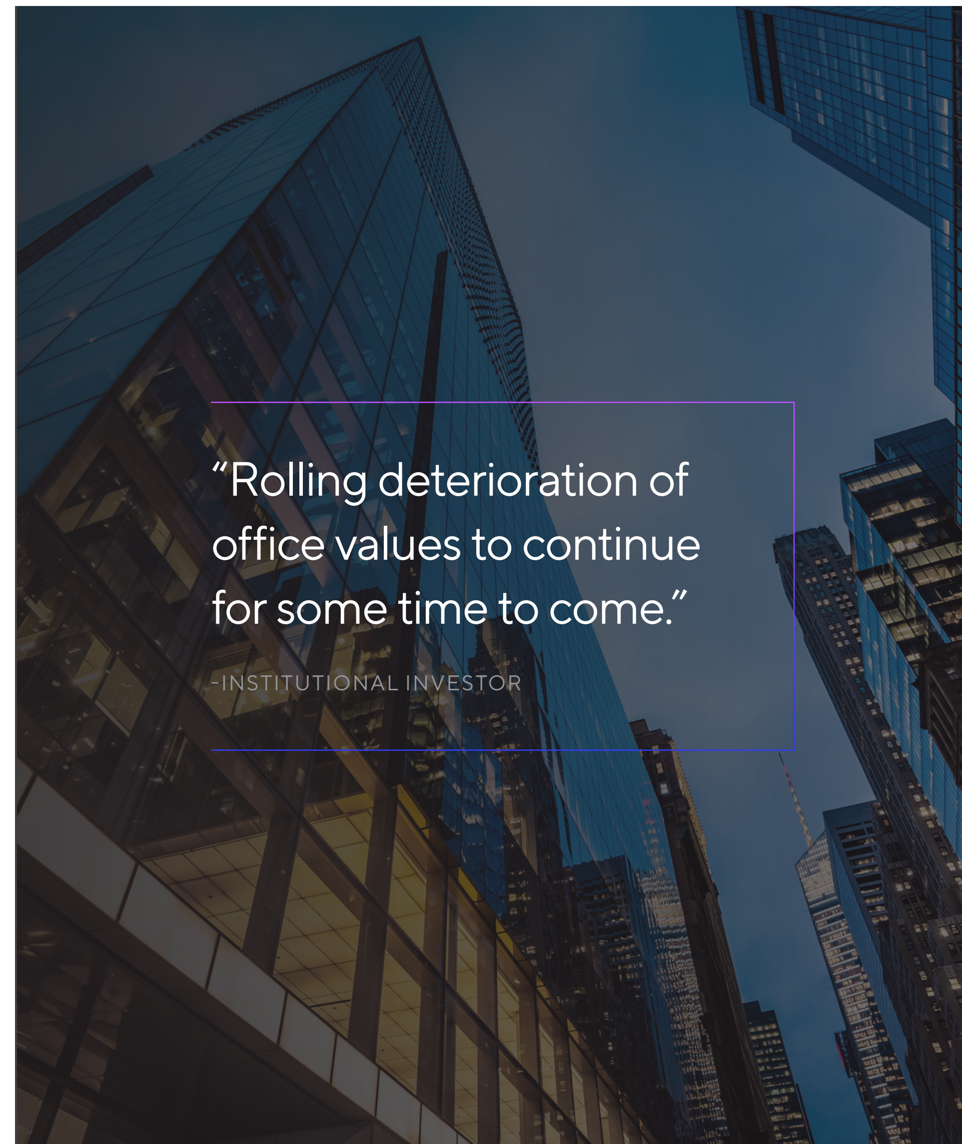
According to SitusAMC, office values continue to deteriorate with an estimated 15% value at risk in 2024. Appraisers are looking at occupancy, tenant risk, local economic conditions, and especially weighted-average lease terms (WALTs), with anything less than five years being a concern. Transactions and assets coming to market are indicating significant cap rate expansion, especially on the West Coast.

Concerns are also growing over loan maturities and many banks are becoming more receptive to loan

workouts. With value declines occurring in tandem with a sharp rise in borrowing costs, some landlords are choosing to walk away from their properties. Top-tier properties remain the most in demand. Office is a capital-intensive sector and may require owners to pour a substantial amount of capital for upgrades if they choose to weather the storm.

Cash flows are coming into perspective as year-end actuals and 2024 budgets are being released. Expense increases are dampening net operating income (NOI). Office usage, according to Kastle, has stayed around 50% for well over a year and, consequently, parking and other revenue sources have decreased. Market rents have similarly been adjusted, especially in San Francisco and New York. Stabilized occupancy has decreased and adjustments are being made to lower renewal probabilities, although as tenants renew leases, many are considering downsizing. Tenant improvement (TI) costs continue to rise, and landlords are focusing on amenities in order to stay attractive in the very competitive market.

According to The Wall Street Journal, CMBS default rates offer a glimpse into the mounting pressures on banks' loan books. Of the $35.8 billion of office CMBS loans that matured in 2023, only 26% were paid in full. More than 1,000 CMBS office loans, worth $14.8 billion, are in special servicing.



SitusAMC Industrial Insights

Warehouse occupancy declined for the fifth consecutive quarter, to the lowest level in almost two years, according to Reis. Still, occupancy is close to 540 bps above pre-pandemic levels and the LTA. Net absorption slowed considerably QoQ, to the lowest since the GFC, though it remained positive.

Fourth quarter warehouse completions were the lowest since early 2019. Effective rent growth once again decelerated from record levels, growing by just 0.5%, the slowest pace since third quarter 2020 and about 40 bps below the LTA. Still, rents are 43% above pre-pandemic levels following the epic run-up in 2021 and 2022. Ongoing supply shortages should keep rent growth afloat.

Values are declining in the broad industrial market, according to SitusAMC, with an estimated 7% to 8% of value at risk in 2024. Rent growth is slowing as demand weakens, absorption cools and vacancies uptick.

SitusAMC reports that Southern California (SoCal) is faring the worst with a marked regression in terms of leasing fundamentals after exponential rent growth over the past few years. Inland Empire and other port markets are also seeing retreating rents. Oversupply from both new deliveries and infill has resulted in a large amount of availability in the Inland Empire and SoCal regions. In these areas, tenants are reluctant to take on new space and there has been pushback on rents. Industrial prices are exceptionally high in these areas and there has been a material pullback in rates. However, there are pockets of optimism, including in South Florida where rent growth and demand are strong.

Global supply chain issues during the pandemic have led to a shift in U.S. trade patterns. The New York Times reports that in 2023, the U.S. bought more goods from Mexico than from China for the first time in 20 years. Last December, imports from South Korea were the highest on record due, in part, to President Biden’s electric vehicle tax credits, which have created new U.S. vehicle supply chains.

NPI Total Return: -2.3%

Warehouse Occupancy Change: -20 bps QoQ

Warehouse Effective Rent Growth Change: +0.5%

> “Least capital intensive and less vacancy risk.”
>
> -EAST REGION INVESTOR

Sources: NCREIF, Reis, SitusAMC Insights, 4Q 2023.

SitusAMC Retail Insights

Retail fundamentals remain stable, with the occupancy rate unchanged for the fourth consecutive quarter, according to Reis. Although that's the highest level since the beginning of the pandemic, occupancy was still 120 bps below the LTA. Retail completions were the second lowest on record. Net absorption turned negative for the first time since the end of 2020. Effective rents have consistently grown slowly for almost three years and have surpassed pre-pandemic levels by 0.5%.

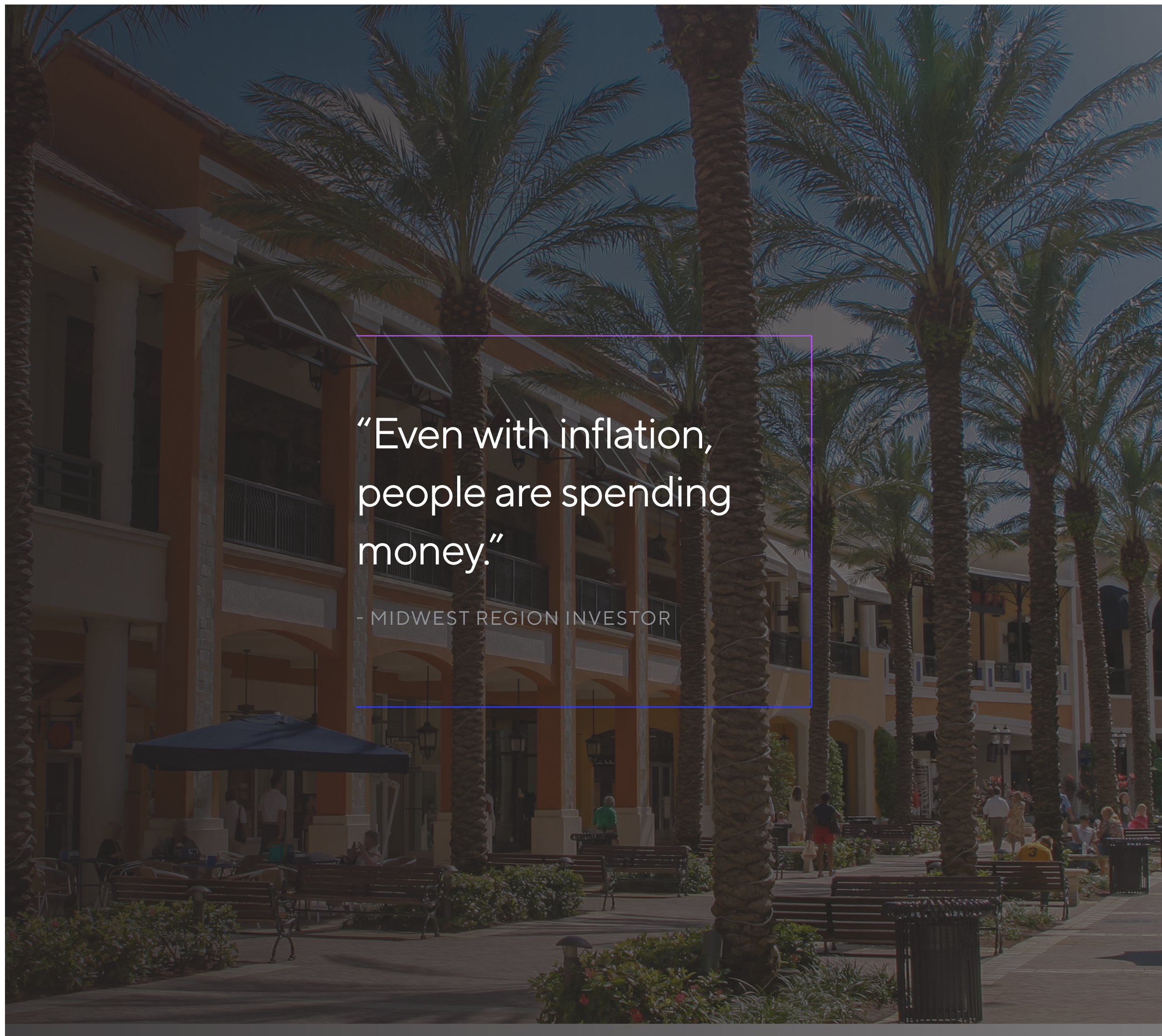
According to SitusAMC, retail has remained relatively steady with stable occupation, mostly positive lease trade-outs, modest increases to market and contract rents, and a pickup in NOI growth. Still, retail is looking at about 5% reduction in value in 2024.

SitusAMC finds that issues remain with relatively large bid-ask spreads, but the hope is that a greater number of transactions by year-end will provide greater price discovery. Investors are looking toward opportunistic properties, but the consensus is that the availability

of these properties might be drying up. Buyers are waiting for a stabilization in interest rates before they begin purchasing properties, although there does seem to be a large amount of capital on the sidelines.

Grocery-anchored center fundamentals are favorable to the landlords, with limited supply and great demand. Suburban locations are outperforming CBD, in part due to work-from-home trends shifting more shopping to close-to-home retail. Consumer sentiment is strong, but with high interest rates, lack of affordable housing, and student loan payments affecting people's budgets, this is expected to pull back.

Demand is high and rent growth is solid for big box spaces with grocers, off-price retailers and fitness centers; however large tenants may have more bargaining power which could dampen future rent growth slightly. New supply is constrained due to difficulty in getting developments to pencil out with current market rents. The limited supply coming online tends to be focused on redevelopment into mixed-use and free-standing, single-asset retail.



> "Even with inflation, people are spending money."
>
> - MIDWEST REGION INVESTOR

SitusAMC Apartment Insights

Apartment demand weakened in fourth quarter, with occupancy declining to the lowest level since mid-2021, per Reis. Fourth quarter occupancy was 10 bps below the LTA. Net absorption, though positive, was the lowest since the GFC. Completions declined QoQ to the lowest level since 2015. Effective rents fell by 1.6% in fourth quarter, the worst loss since third quarter 2020. Because of the record high rent growth in 2021 and 2022, rents remain significantly higher than pre-pandemic levels, near 20%.

According to SitusAMC, apartment saw its largest value decrease of 2023 in the fourth quarter of around 4.3%, largely driven by the expansion of investment rates. Exit rates, discount rates, and going-in rates all expanded by roughly 25 bps. In the current quarter, values continue to decrease but at a decelerated pace compared to year-end with much of the changes coming from cash flow adjustments, as investment rate changes have been case-by-case. Additional value at risk in 2024 may be up to 10%.

Many assets that were seeing positive leasing are now seeing a slowdown, though seasonality could be playing a factor. Markets seeing negative or slower rent growth or a larger effect of economic loss are largely located in the West, such as Portland, Seattle, San Francisco and the Bay Area, where supply is greatly outpacing demand. Some Sun Belt locations are also starting to see similar trends, including Phoenix and Atlanta and several Florida markets.

SitusAMC is seeing negative value allocation coming from expenses, which hits apartment NOI especially hard because the sector does not get reimbursements for expenses. Rising insurance costs are a concern, particularly in Florida and other coastal markets. Older vintage assets with wood structural frames are being hit the hardest on insurance costs. Other expense increases include payroll, taxes, repairs and maintenance, and utilities. However, one of the greatest components of potential value at risk for apartments is in lease trade-out premiums as contract rents begin to soften and short-term concessions burn off.

NPI Total Return	-3.0%
Occupancy Change	-20 bps QoQ
Effective Rent Growth Change	-1.6%

"Rent increases are not meeting expectations."

-MIDWEST REGION INVESTOR

Sources: NCREIF, Reis, SitusAMC Insights, 4Q 2023.

SitusAMC Hotel Insights

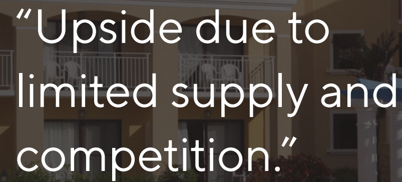
Seasonally adjusted hotel occupancy increased 40 bps QoQ to the highest level since second quarter 2022, according to Reis. The current occupancy rate is over 600 bps higher than the LTA, and only 10 bps below the pre-pandemic rate. Reis forecasts the occupancy rate to surpass pre-pandemic levels by early 2024.

Seasonally adjusted room rates declined for the third consecutive quarter by 0.4%, reaching the lowest level since first quarter 2022. A slight uptick QoQ in RevPAR led to the highest rate in over a year. Room rates and RevPAR were over 30% and 40% above the LTA, respectively, and each were about 14% higher than pre-pandemic levels.

Lower-tier hotels surpassed their pre-pandemic occupancy in fourth quarter after a more than 100 bps increase QoQ, according to Reis. Upper-tier hotel occupancy continues to lag, with fourth quarter occupancy declining 30 bps. Upper-tier hotel occupancy in fourth quarter was over 300 bps

lower than pre-pandemic levels. Lower-tier hotels also outperformed upper-tier hotels on a RevPAR basis in fourth quarter, with a 0.8% increase for lower-tier and a 0.1% decline for upper-tier QoQ.

An American Hotel & Lodging Association poll from January 2024 found that 72% of Americans expect to maintain or increase the number of times they stay in a hotel in 2024 compared to the previous year. The outlook is rosier for leisure travel than business travel; 53% of adults plan to spend one or more nights away from home for vacation or leisure travel through April, while only 32% of adults expect to do so for business travel.



> "Upside due to limited supply and competition."
>
> - EAST REGION INVESTOR

ValTrends by SitusAMC

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