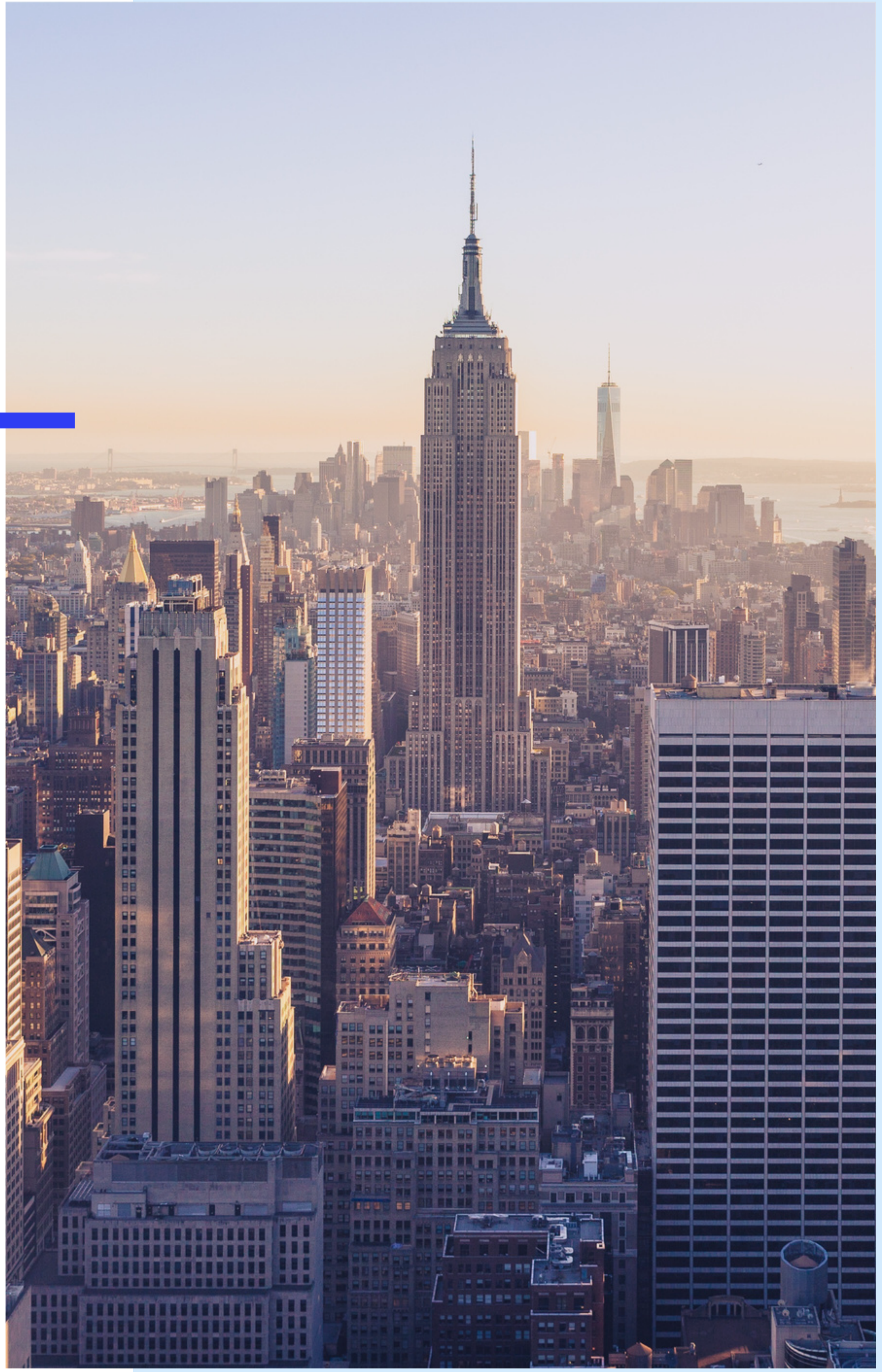
SitusAMC

6 Macro Trends to Watch in 2024

Commercial Real Estate



INTRODUCTION

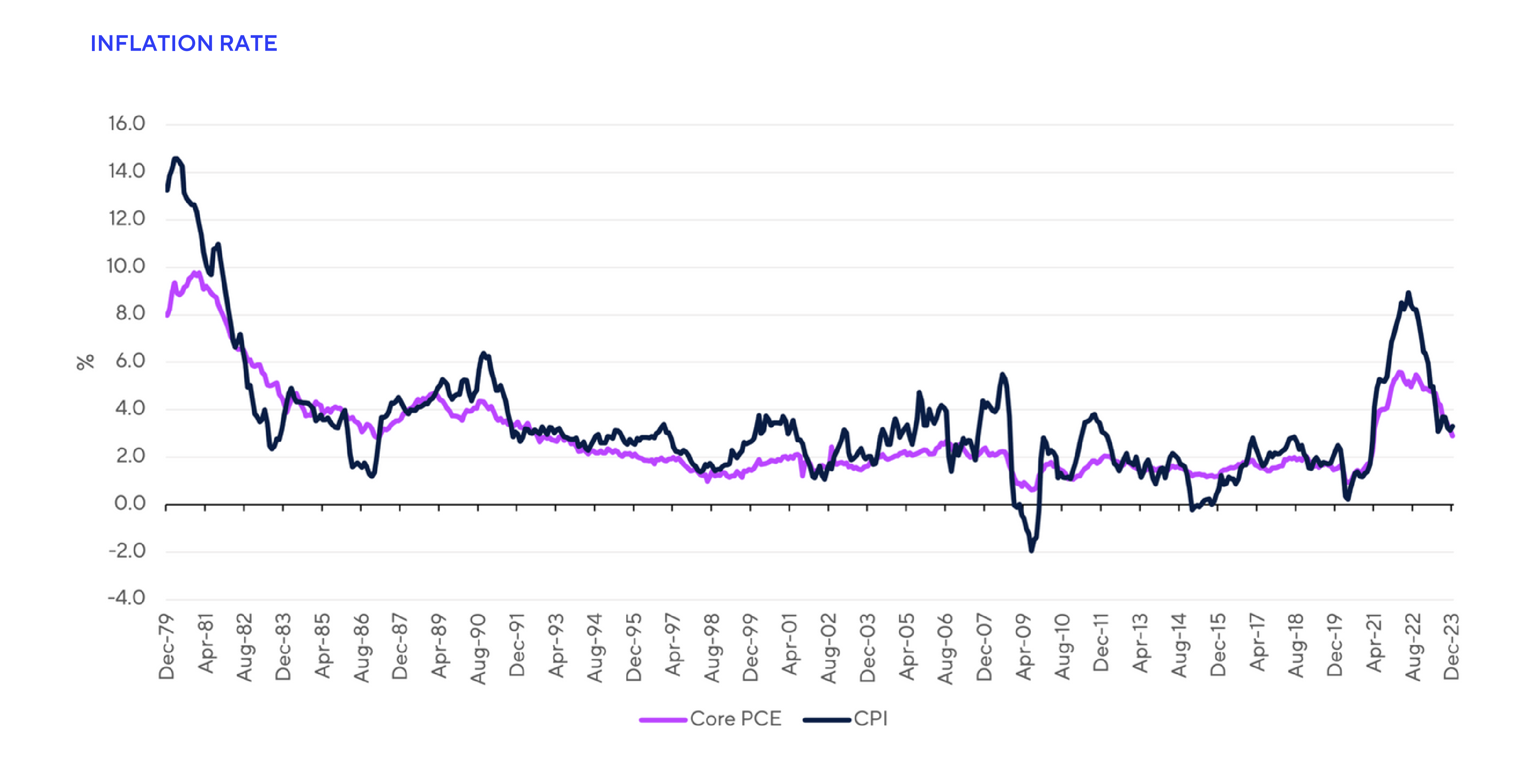
The watchword for 2024 appears to be resilience. The U.S. economy is on relatively solid footing, with gross domestic product (GDP) rising 3.3% in 4Q 2023 on an annualized basis, following a 4.9% spike in third quarter. The labor market remains strong, and inflation has decelerated from the 40-year highs seen in mid-2022. SitusAMC has identified six macro and interconnected themes to watch in 2024. Some will offer economic and real estate market stability while others create risk. However, these themes generally lead us to predict a thawing of the freeze we saw in commercial real estate activity last year.

1 Interest Rates & Inflation

The sharp rise in interest rates has been the primary culprit in recent capital markets turmoil. To tame soaring inflation, the Federal Reserve raised the federal funds rate 11 times between 2022 and 2023, for a total of 525 basis points (bps). At the end of 2023, the Fed set the benchmark rate at 5% to 5.25%, and interest rates reached a near two-decade high in October 2023. Treasuries and mortgage rates retreated at the end of 2023 as the Fed kept interest rates unchanged; however, rates remained historically elevated.

While the rise in interest rates has led to declining transactions and origination activity, the Fed's actions appear to have cooled inflation. The seasonally adjusted consumer price index (CPI) measure of inflation reached a 40-year high of 8.9% in mid-2022, kicking off the Fed's aggressive action. The CPI decelerated by 560 bps by the end of 2023. Core personal consumption expenditures (PCE), the Fed's preferred inflation measure, fell to a 2.9% annualized rate in December while headline inflation came in at 1.7%, below the Fed's target of 2%, and well under its peak in February 2022.

INFLATION COOLS FROM 40-YEAR HIGHS IN 2023

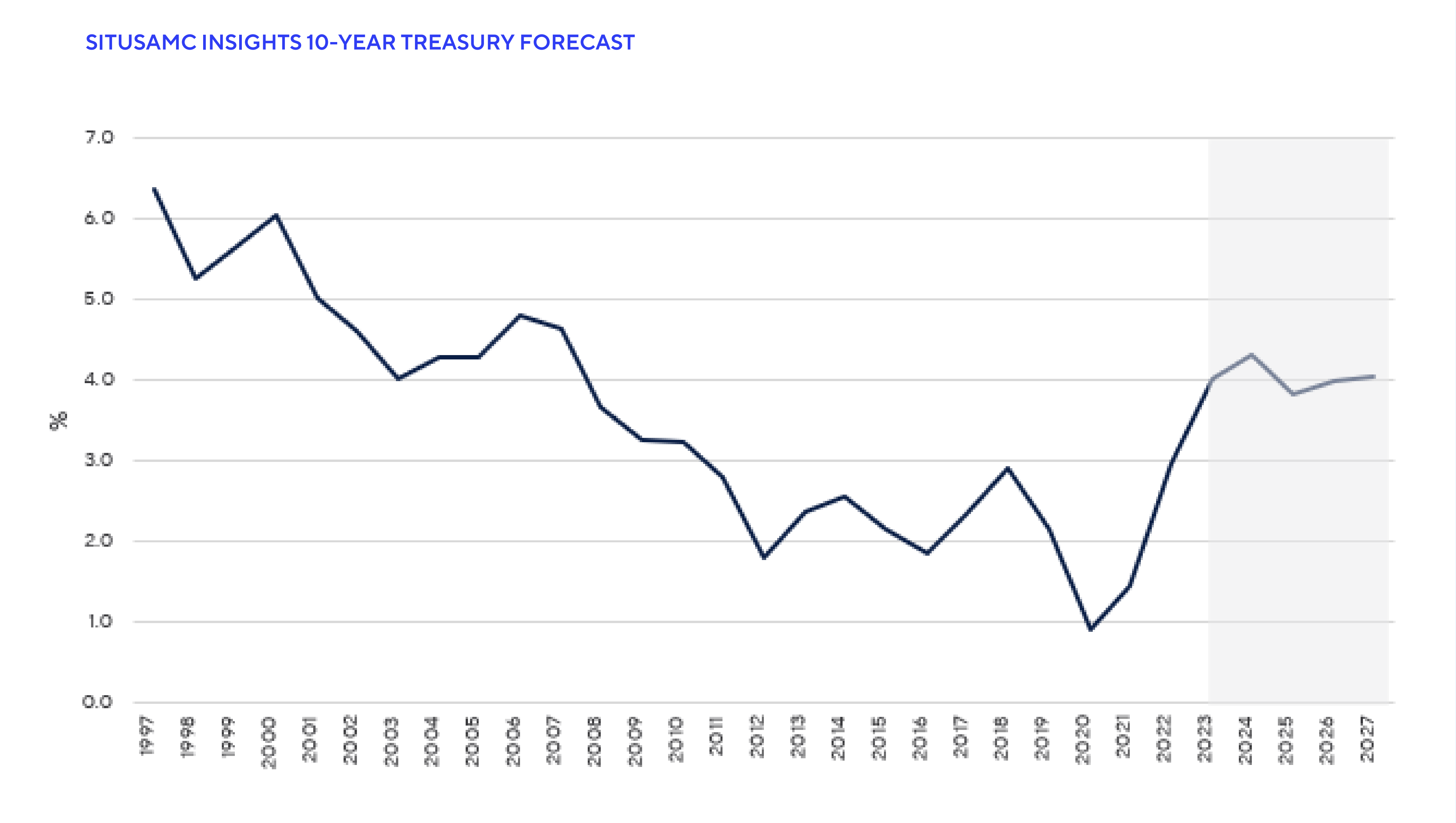


Source: BEA, BLS, SitusAMC Insights, December 2023.

The Fed's summary of economic projections (SEP), released in December 2023, indicated that the Fed will likely cut rates three times in 2024. The median federal funds rate projection was 4.6% in 2024, with all SEP participants projecting rate cuts during the year. However, the robust economic growth in the 4Q 2023 is likely to delay any easing to later in 2024. Projections are for the federal funds rate to fall further in 2025 to 3.6%.

An analysis by SitusAMC Insights predicts the 10-year Treasury will increase slightly in 2024 to 4.3% before declining to 3.8% in 2025. Stability in rates should help spur transaction and origination activity.

10-YEAR TREASURY EXPECTED TO REMAIN NEAR CURRENT RATES OVER THE NEXT SEVERAL YEARS



Note: Data based on annual averages. Shaded area indicates forecast.
Source: SitusAMC Insights, Federal Reserve, 3Q 2023.

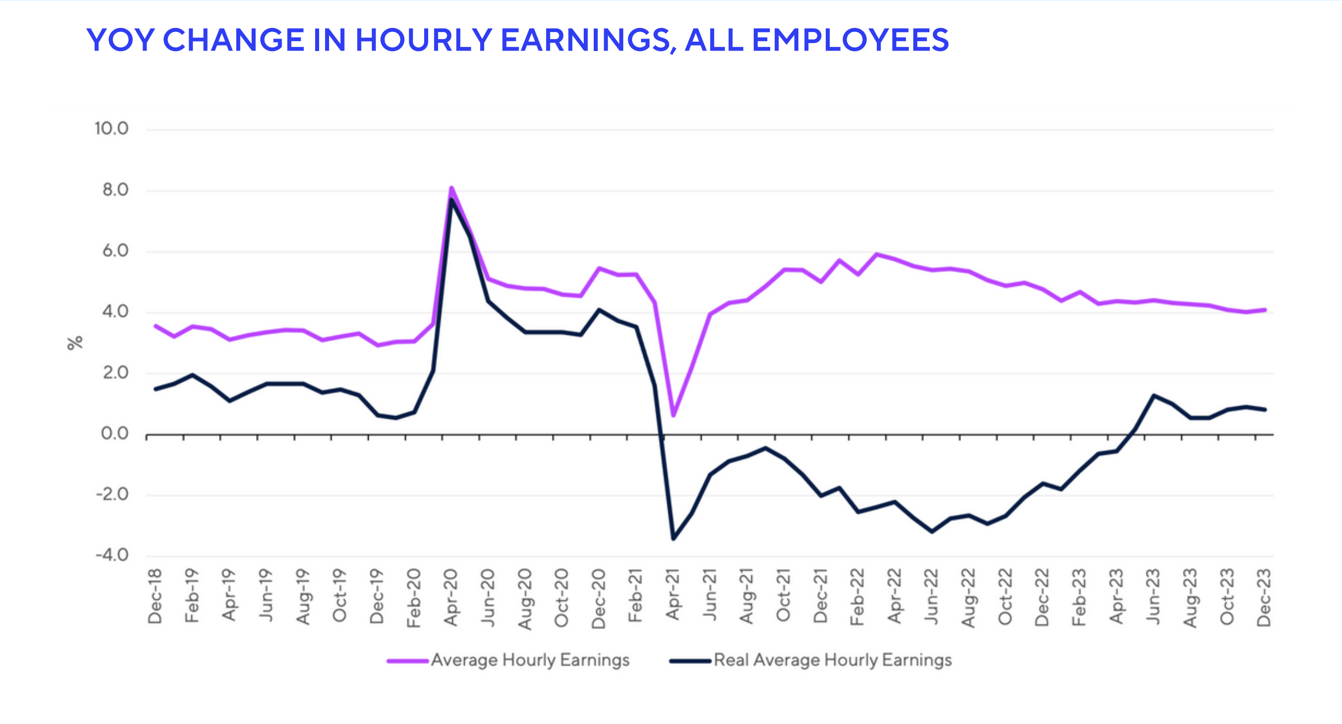
2 Consumer Financial Health

The labor market has remained remarkably resilient amid the Fed's aggressive rate-hike campaign. After peaking at 14.8% during the COVID-19 pandemic, the unemployment rate had dropped to 3.7% as of December 2023, well under the historical average of 5.8% and even below the Fed's 4% benchmark for full employment. Meanwhile, opportunities remain plentiful, with the job openings rate (ratio of job openings to population) remaining exceptionally high from a historical standpoint. The cushion in available jobs suggests that the labor market will remain healthy enough to support economic growth in the coming year, even if interest rates remain elevated.

Wage growth data suggests a relatively healthy consumer. Average hourly wages increased 4.1% in 2023 and over 20% since the onset of COVID-19. By comparison, annual wage growth over the last 15 years has averaged 3%. Ultra-high inflation has certainly eaten into consumers' wallets recently. However, inflation-adjusted real wages have grown 1.1% since the onset of COVID-19. In 2023, real annual wage growth averaged 0.8%, 20 bps higher than the 15-year average.

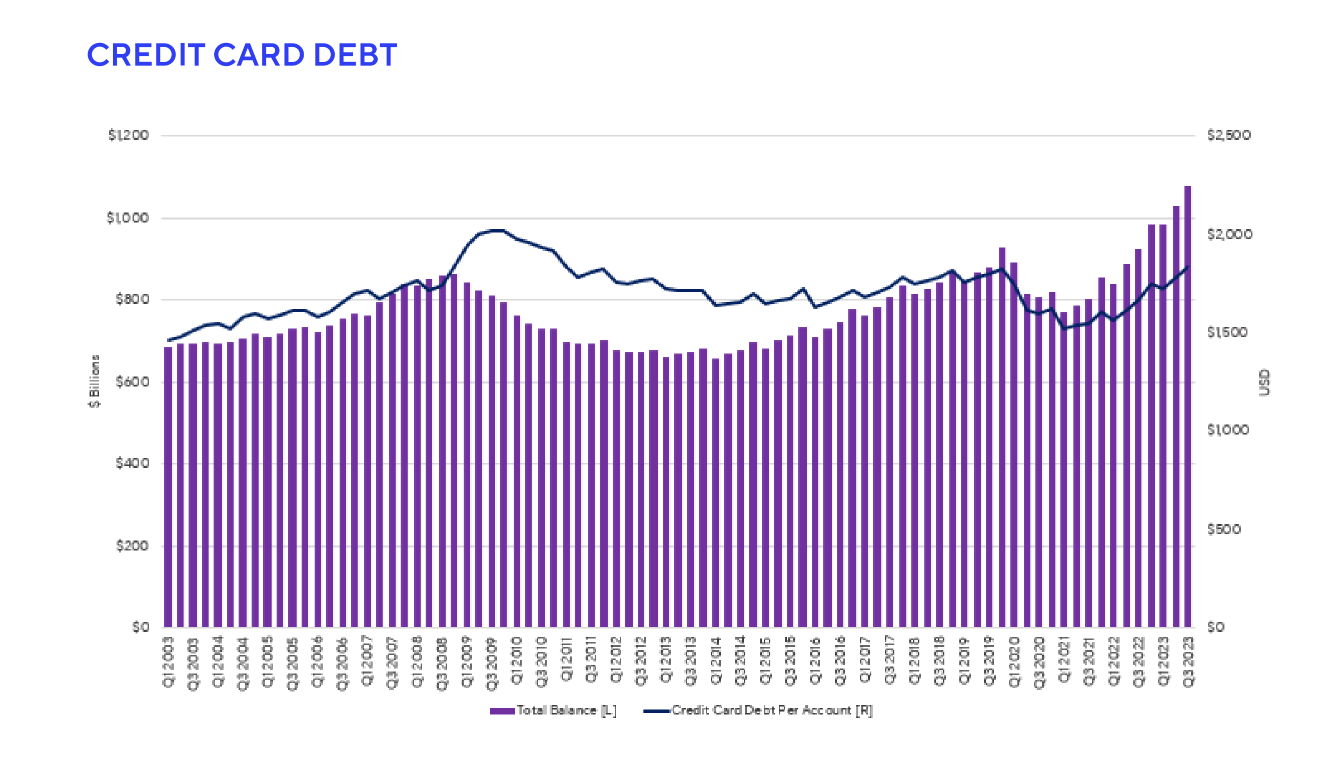
Though the financial health of the consumer is expected to remain relatively robust in 2024, one trend to monitor is consumer debt. Credit card debt, which began rising rapidly in 1Q 2021, hit a record $1.07 trillion in 3Q 2023, a 16.6% increase YoY. The average credit card debt per account also spiked, to $1,830, the highest amount since 2011. Meanwhile, delinquencies (90+ days) jumped by more than 24% YoY, though the rate of 9.4% in 3Q 2023 equaled the 15-year average.

WAGE GROWTH DECELERATES IN 2023 BUT REMAINS ABOVE HISTORICAL AVERAGE



Source: BLS, SitusAMC Insights, December 2023.

RISING CREDIT CARD DEBT SIGNALS POTENTIAL CONCERN FOR CONSUMER FINANCIAL HEALTH



Source: Federal Reserve Board of New York Consumer Credit Panel/Equifax, SitusAMC Insights, 3Q 2023.

3 Population Growth & Domestic Migration

Population growth drives real estate demand, and the Sun Belt is still winning the lion's share. The U.S. population grew 0.5% in 2023, up from 0.4% growth in 2022, according to the U.S. Census Bureau. Domestic migration (i.e., migration between states) accounts for the largest share of population growth. In 2023, the largest percentage increases in domestic migration occurred in many of the Sun Belt States: South Carolina (1.1%), Delaware (1.0%), North Carolina (0.9%), Tennessee (0.9%) and Florida (0.9%). The biggest losers on a percentage basis included states with large urban metros: New York (-1.1%), California (-0.9%) and Illinois (-0.7%) as well as Hawaii and Alaska (both at -0.8%).

MANY SUN BELT STATES BENEFITTING FROM DOMESTIC MIGRATION; NEW YORK AND CALIFORNIA SEEING MOST OUTMIGRATION

	State	2023 Change in Domestic Migration (%)	2023 Change in Domestic Migration (#)
Top 10 Markets	South Carolina	1.5%	82,562
	Delaware	1.0%	10,320
	North Carolina	0.9%	97,264
	Tennessee	0.9%	63,417
	Florida	0.9%	194,438
	Montana	0.8%	9,485
	Idaho	0.8%	15,389
	Maine	0.7%	9,216
	Texas	0.6%	186,767
	Alabama	0.6%	30,744
Bottom 10 Markets	New York	-1.1%	-216,778
	California	-0.9%	-338,371
	Hawaii	-0.8%	-11,193
	Alaska	-0.8%	-5,543
	Illinois	-0.7%	-83,839
	Louisiana	-0.6%	-29,692
	Massachusetts	-0.6%	-39,149
	Maryland	-0.5%	-30,905
	New Jersey	-0.5%	-44,666
	Rhode Island	-0.3%	-3,224

Source: BLS, SitusAMC Insights, December 2023.

4 Geopolitics

With the ongoing turmoil between Israel-Hamas and Russia and Ukraine, geopolitics are weighing on investors' minds. While the economic fallout from these wars has thus far been manageable in the U.S., further escalation of geopolitical tensions could lead to a pullback in GDP and an increase in inflation.

The war in Ukraine has had relatively little effect on U.S. trade. Trade with Russia represented just 0.03% of total U.S. exports and 0.15% of total U.S. imports year-to-date through November 2023. Similarly, trade with Israel makes up just 0.7% for both imports and exports. However, slowing imports can also lead to a rise in inflation. U.S. imports from Russia plummeted from $2.8 billion at the start of the war to $362 million in November 2023. Sanctions on Russian oil and commodities likely contributed to the surge in energy and food costs in the U.S. Concerns are growing that the Israel-Hamas war could also influence trade energy prices. As the U.S. and Britain have ramped up counterattacks against the Houthis in Yemen to protect commercial ships in the Red Sea, OPEC member Iran has begun sending weapons to the Houthis, setting up the potential for a U.S.-Iranian proxy war.

In addition, Time reports that at least 64 countries (plus the European Union), representing 49% of the world's population, will hold national elections in 2024. More voters will go to the polls this year than ever in history. The Taiwanese people elected incumbent Vice President Lai Ching-te for president in January, which analysts say could escalate tensions with China. Should they erupt into conflict, a global recession would be likely. War over Taiwan could cost as much as $10 trillion, or more than 10% of global GDP, Bloomberg Economics estimates. By comparison, the costs of the Great Financial Crisis and COVID-19 were each about 6% of global GDP.

Meanwhile, the U.S. faces a presidential election in November and the impact of the policies that will follow. Republican frontrunner Donald Trump's policies include higher tariffs on international imports, support for Israel, a contraction of financial support to Ukraine, increased oil drilling and rollbacks of clean-energy policies. Democratic frontrunner Joe Biden's policies include access to affordable health care for all, relief to those still burdened by the COVID-19 pandemic, higher taxes for billionaires and large corporations, support for small business, and job creation.

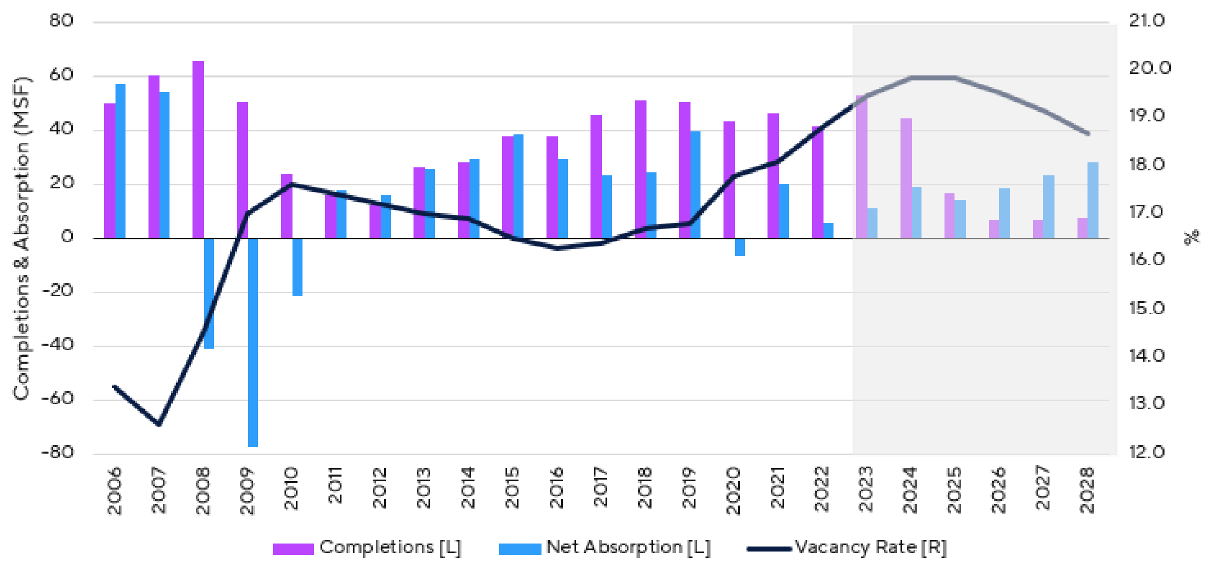
5 Evolving Work Models

About 22% of employees worked remotely some or all of the time in December 2023, up from 9% in February 2020, according to the Bureau of Labor Statistics. But this varies greatly by industry, with up to 60% of employees in industries in information, financial activities and professional and business services working remotely some or all of the time. Though many companies have announced plans to return to office (RTO), the workforce is resisting: 98% of workers want to work remotely at least some of the time and 57% of workers would look for a new job if their employers stopped allowing remote work, Forbes reported. The continued tight labor market makes it difficult for firms to implement RTO policies.

The remote work trend has had profound effects on office real estate. The average square footage per office employee was approximately 115 in 3Q 2023, down about 4% from pre-pandemic levels, according to Reis data. Office vacancies rose to a record of more than 19% in 3Q 2023. SitusAMC Insights forecasts show that the sector will continue to struggle for several years with high vacancies and rent declines, even as new supply diminishes. Watch for new Class A product to focus on flexible design and high-touch experiences that attract workers back to the office.

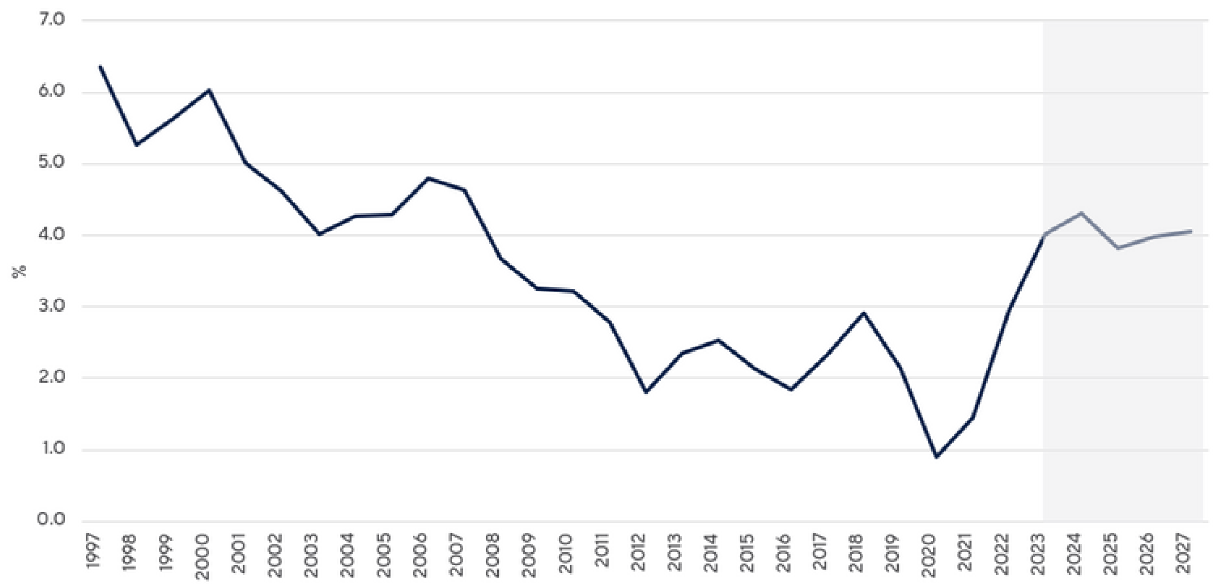
OFFICE OVERSUPPLY AND WEAK DEMAND WILL LIKELY LEAD TO RENT DECLINES OVER NEXT FEW YEARS

SITUSAMC OFFICE FUNDAMENTALS FORECAST - SUPPLY / DEMAND



Source: Reis, NBER, SitusAMC Insights Forecasts, 3Q 2023.

SITUSAMC OFFICE FUNDAMENTALS FORECAST - EFFECTIVE RENT GROWTH



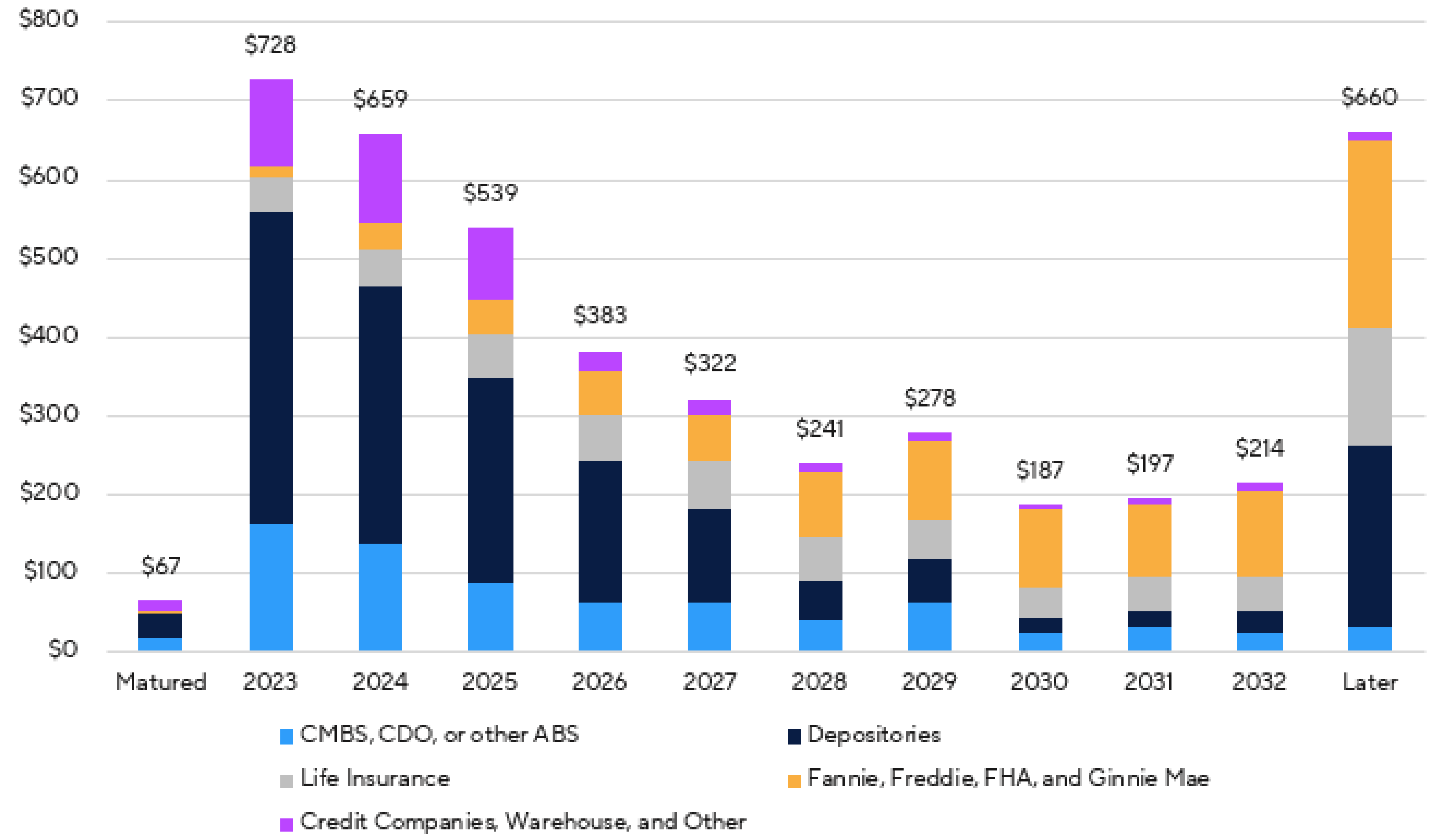
Source: Reis, NBER, SitusAMC Insights Forecasts, 3Q 2023.

6 Debt Distress & Alternative Lenders

The commercial real estate market is reeling from higher interest rates, declining property values, particularly in the office sector, and the withdrawal of key players from lending. Large mortgage REITs, including Blackstone, KKR and Starwood, pulled back significantly on lending in 2023, according to The Wall Street Journal. Depositories and CMBS/conduits decreased originations in 2023, while alternative lenders, including life insurance companies, investor-driven lenders, and Fannie Mae and Freddie Mac stepped in to fill the gap. An estimated $727.9 billion of loans are coming due in 2024 with another $658.7 billion maturing in 2025, mostly through depositories. Given the recent retreat of traditional lenders it is likely that alternative lenders will play a larger role in commercial real estate finance over the next few years.

OVER $1.3 TRILLION IN LOANS COMING DUE BY 2025, MOSTLY FROM DEPOSITORIES

MATURITY WALL BY LOAN TYPE



Source: MBA, SitusAMC Insights, December 2023.

About SitusAMC

SitusAMC is the leading independent provider of innovative, trusted solutions powering the entire lifecycle of commercial real estate finance. We are trusted by more than 1,500 clients including banks, P/E firms, asset managers, servicers, CMBS issuers, and insurance companies.

Our Commercial Real Estate Offering

- Underwriting, Due Diligence & Advisory Services
- Securitization Support
- Primary Servicing & Asset Management
- Special Servicing & NPL Management
- Real Estate Valuation Services
- CRE Debt & Securities Valuation Advisory Services
- Origination & Asset Management System – CLOSER
- Valuation Management System - VMS
- Daily Valuation System – DVS
- CRE Asset Underwriting System – rDCF

New Origination Support
$23B+
Supported in '22

Servicing & Asset Mgmt.
$177B
Of UPB managed across the US & Europe
(As of Dec '22)

Securitization Support
58
Rated securitizations supported in '22

Special Servicing
$121B+
Of UPB we are named special servicer on in the US
(As of Dec '22)

Debt & Securities Valuation
$130B
Debt valued quarterly across the U.S. & EMEA

Data, Analytics & Research
100+
Years of combined analytics and real estate expertise

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