

# Economic Update

 **SVN** | Research

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## 1. EMERGING TRENDS IN REAL ESTATE

- Investors and developers should expect an upturn in fate for the commercial real estate industry as post-pandemic disruptions abate and positive cyclical forces reemerge, according to ULI-PwC's Emerging Trends in Real Estate (ETRE) report for 2025.
- The likelihood that the US economy has moved beyond peak inflation and peak interest rates arises as the most important cyclical factor in the report. Falling rates are reducing construction costs and boosting construction activity. **Nonetheless, falling rates are also indicative of a slowing economy, encouraging some dealmakers to wait things out.**
- The share of survey **respondents who expect their firm's profit to be "good" or "excellent" is more than 20 percent higher than last year.** However, many investors expect the neutral rate of interest to be higher than before the Fed's tightening cycle and don't foresee a return to pre-pandemic growth levels.
- ETRE 2025 also discusses the emergence of specific supply dynamics that will differentiate the upcoming cycle from previous ones. For example, a modernized stock of office buildings intensifies the struggle of aging buildings in today's distressed environment, with older, less amenitized buildings struggling to compete.
- From the view of the report, CRE's "new normal" has arrived, with the effects of remote work and online shopping essentially baked into developer outlooks. Meanwhile, responses suggest growing worry that tenant demand may struggle to keep up with the construction boom seen across many sectors.

## 2. ELECTION IMPLICATIONS ON CRE

- Donald Trump won the 2024 Presidential Election, which, alongside a Republican victory in the Senate and a House that is still up for grabs, suggests that the commercial real estate industry will pivot towards a **more favorable regulatory environment yet with greater supply chain uncertainty.**
- The GOP White House and Senate win drastically reduces the likelihood of new taxes on capital and will renew pressure towards reducing regulatory barriers to supply, which could even see bi-partisan success in a split-government scenario where Democrats win the House.
- **Global trade** uncertainties, including the **incoming administration's planned use of tariffs**, complicate the

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outlook for input costs. Construction costs may climb if significant tariffs are applied to input materials imported from foreign economies and an escalating trade war ensues, while a major deportation effort would likely drive-up labor costs.

- Several state and local ballot measures surrounding residential rent control were also held on election day. California rejected Proposition 33, which would have removed state prohibitions on rent control by municipal governments. Elsewhere, Hoboken, NJ, voted to retain rent control rules, shooting down a measure that would have allowed for a market reset of rents upon turnover.

## 3. Q3 GDP

- Real GDP rose by a 2.8% annualized rate in the third quarter, according to the Bureau of Economic Analysis (BEA), slowing from the second quarter rate of 3.0%.
- Increases in consumer spending, exports, and federal government spending contributed to the increases, while an uptick in imports, a subtraction from the GDP calculation, slightly moderated its growth.
- Consumer spending increases in goods were dominated by prescription drugs, other non-durables, and motor vehicles and parts. Health care and food services/accommodations were the main contributors to services.
- The deceleration in real GDP relative to the second quarter primarily reflected a decline in private inventory and residential fixed investment. Meanwhile, an acceleration in exports, led by capital goods, and government spending, led by defense, partly offset declines in investment.

## 4. ISM SERVICES

- According to the Institute of Supply Management, US services activity rose by its highest amount in over two years in October, reaching an index level of 56 – not seen since August 2022.
- The strength in the US service sector was primarily driven by an employment rebound and slower supplier delivery performance, which is a downward force on the index as it accelerates.
- Price pressures in the services sector also eased slightly, while business activity/production, new orders,

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and inventories each experienced shallow increases. Meanwhile, the index tracking order backlogs shrank.

- According to the committee analyzing the report, political uncertainty was more prevalent in this month's report than in the previous month. Meanwhile, labor disputes and hurricane impacts were frequently mentioned in survey responses, indicating their effect on economic activity during October.

## 5. COMMERCIAL PROPERTY PRICES

- According to the latest MSCI RCA Commercial Property Price Index, real estate prices fell monthly in September for the third consecutive month. The National All Property Index fell 0.3% from August and 1.9% year-over-year.
- Industrial was the only property type with an annual gain, climbing 6.7% year-over-year, roughly in line with the sector's growth in the past three months. Industrial prices are up 0.4% from August.
- Apartment prices are down 6.3% year-over-year, the largest drop by any property type outside of the widely distressed office sector. Nonetheless, Apartment price declines have moderated over the past year. For context, in September 2023, apartment prices were falling 13.4% year-over-year.
- Office sector prices are down 8.0% year-over-year, with assets in commercial business districts continuing to experience the largest declines, down 22.4% in the past 12 months. Comparatively, suburban office assets are down just 3.3% year-over-year.
- Retail property prices fell 1.5% from one year ago, which follows a similar trend of declines seen in the sector since the spring. The sector has recovered from the high single-digit declines registered about a year ago. The retail index fell just 0.1% month-over-month from August.

## 6. OFFICE DEMAND

- According to VTS' Office Demand Index (VODI), nationwide office demand has climbed by 11.8% in the past year, and analysts expect this growth momentum to continue.
- All major local markets tracked by the VODI have increased relative to one year ago except for Washington, DC, which analysts believe reflects a frozen transaction landscape brought on by the uncertainty of the

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2024 election.

- **New office demand is highest in Los Angeles and New York**, though much of this gain has taken place over the past two years while the two metros have seen demand recede slightly in recent months.
- The report also notes that work-from-home rates in recent months have been the lowest since the start of the pandemic, a trend that appears to be industry-agnostic. Today, **less than one-third of work days are spent at home**, and this downward trend **contributes to a more bullish outlook for the office compared to one year ago**.

## 7. LOGISTICS MANAGERS INDEX

- The Logistics Manager's Index rose to 58.9 in October, its highest level since September 2024, a tick above the 58.6 registered in September. US logistics growth has been consistently solid over the past six months
- Faster increases were seen for warehouse utilization, transportation utilization, and transportation prices, the latter of which experienced its most rapid growth rate since May of 2022.
- Transportation capacity rebounded from a neutral reading of 50 in September. Meanwhile, inventory levels continue to expand but at a slower rate compared to other logistics components, as did inventory costs and warehousing capacity.

## 8. EXTEND AND PRETEND

- A recent analysis by the Federal Reserve of New York suggests that during the post-pandemic period, some banks **"extended and pretended"** their distressed CRE mortgages, a practice of extending the maturing loans to avoid writing off their capital, **leading to credit misallocation**.
- Using loan-level supervisory data on maturity extensions, the analysis found that "extend-and-pretend" crowds out new originations and led to a 4.8-5.3% drop in CRE mortgage origination since Q1 2023.
- As a result, the number of CRE mortgages maturing in the near term has climbed, standing at 27% of total bank capital as of Q4 2024.
- While extensions led to fewer defaults, banks took these actions due to weak underlying capitalization,

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which resulted in a strong positive relationship between maturity extensions for distressed mortgages and bank undercapitalization.

## 9. OCTOBER JOBS REPORT

- The US economy added just 12,000 payrolls in October as extreme weather events and a significant labor strike sharply eroded job growth.
- According to the Bureau of Labor Statistics, a major strike at Boeing likely subtracted 44,000 jobs in the manufacturing sector, while two severe hurricanes virtually halted hiring activity in affected regions.
- The unemployment rate was virtually unchanged at 4.1%, while a broader measure that includes discouraged workers and those working part-time for economic reasons was similarly unchanged, holding at 7.7%.
- Average hourly earnings rose 0.4% in October at 4% over the past year.
- Overall, markets had a muted reaction to the numbers. October's job activity further cements expectations that the Federal Reserve will move forward with another interest rate cut at its November meeting.

## 10. HIGHER INFLATION FOR LOW-INCOME HOUSEHOLDS

- Construction spending rose to a seasonally adjusted annualized rate of \$2.14 billion in September, 0.1% above August's pace. The annualized rate of construction in September 2024 was 4.6% above the September 2023 estimate. Meanwhile, during the first nine months of the year, construction spending outpaced the same period in 2023 by 7.3%.
- The pace of private construction spending was roughly unchanged from the previous month, as a decline in nonresidential construction activity mostly offset an increase in residential construction spending.
- The annual rate of public construction spending rose 0.5% above its August pace. The annual pace of Educational construction rose 0.3% above its revised August estimate, while highway construction rose 0.5% above its revised August estimate.

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## SUMMARY OF SOURCES

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