Economic Update

SVN | RESEARCH

FEBRUARY 27, 2025

1. PROPOSALS FOR PERMANENT BONUS DEPRECATION

- Discussions are heating up around proposals to extend 100% bonus depreciation deductions on certain business assets as tax-extension negotiations gradually take shape.
- The 2017 Tax Cuts and Jobs Act (TCJA) offered 100% bonus depreciation on items such as machinery and equipment from 2018 through 2022 before declining by 20 percentage points annually in each year since.
- Some advocate for its extension as a lever to grow the economy and create jobs, while reviews of the policy show mixed results.
- Scholarly research on the TCJA-based changes shows that the reforms grew capital investment, particularly in the manufacturing sector.
- The Joint Committee on Taxation (JCT) finds that extending the 100% level through 2025 and making it retroactive back to 2023 would reduce federal revenues by $3 billion over ten years.
- However, an analysis by the Tax Foundation suggests that while restoring 100% bonus depreciation wouldn't have significant effects on GDP growth in the immediate term, by 2029, it would add an estimated 0.2% to Real GDP.

2. CONSUMER CONFIDENCE FALLS

- US consumer confidence slid in February by its fastest pace since August 2021, based on the latest data from the Conference Board.
- The Conference Board numbers align with recent developments in the University of Michigan's consumer sentiment measure, which fell to a seven-month low last month. Consumers show increasing concern about buying conditions for goods and threats to their purchasing power.
- Both the present situation index, which measures current assessments of business and labor market conditions, and the expectations index, which looks at the short-term outlook for business and income, declined.
- Notably, the expectations index fell within a 'potential recession' threshold of below 80 for the first time since June of last year. Inflation expectations also surged during the month.

SVN COMMERCIAL REAL ESTATE ADVISORS
svn.com
1309 Beacon St, Suite 300
Brookline, MA 02446

- Through the end of January, some inflation expectations indicators appeared steady, such as the NY Fed's Survey of Consumer Expectations, which showed stable expectations compared to one year before.
- However, the Conference Board data suggests that expectations have unanchored in recent weeks as price pressures resurge and economic uncertainty mounts.
- Some of the culprits may be temporary, such as the rise in egg prices or volatility in energy markets. Therefore, policymakers at the FOMC will be keen to zero in on trends in core inflation expectations to assess potential policy implications.

3. STALLING BUSINESS ACTIVITY

- US business activity in the manufacturing and service sectors fell to a 17-month low in February as uncertainty over tariffs and the federal budget boggs down what had been a post-election boost in business confidence.
- Observing trends in S&P Global's flash US Composite PMI Output Index, manufacturing and service output fell to an index level of 50.4 in February, its lowest reading since September 2023. A reading above 50 indicates growth, indicating that the sectors barely expanded this month.
- Potentially related to both the drop in the PMI and January's inflation uptick is consumer activity shifting away from services and back towards goods. The services sector drove much of the decline after contracting for the first time in two years. Meanwhile, manufacturing activity rose to an eight-month high.
- During the initial pandemic recovery in 2020, goods spending drove both consumer spending and inflation pressures, but the pandemic reopening shifted much of this momentum to services, contributing to our sustained period of inflation.
- It's unclear whether the apparent shift toward goods reflects the temporary effects of consumers trying to get ahead of potential trade restrictions or if we are seeing the impact of falling borrowing costs on producers amid wage and spending stability. There is likely some mix of the two.

SVN COMMERCIAL REAL ESTATE ADVISORS
svn.com
1309 Beacon St, Suite 300
Brookline, MA 02446

4. SURVEY OF HOUSEHOLD EMERGENCY EXPENSES AND DECISION-MAKING

- A quarterly survey by Morning Consult that estimates US households' confidence in their capacity to absorb emergency expenses found that households grew slightly more confident during Q1 2025 relative to the previous quarter but are less optimistic than one year ago.
- 44% of US adults believe they could cover potential emergency expenses with cash, up from 43% last quarter but down from 47% in Q1 2024.
- The survey replicates the hypothetical approach of the Fed's annual Survey of Household Economics and Decision-making (SHED) while secondarily measuring real outcomes reported by consumers who have recently experienced emergency expenses.
- Interestingly, the latest findings show that those who encountered an emergency expense between $200-$600 were able to cover those expenses at a higher rate relative to how they responded hypothetically.
- As US consumer confidence statistics drop, surveys that compare confidence levels to real outcomes add an important layer of analysis.
- So far, consumers appear to be faring better than expected, but the Morning Consult survey period spanned from January 22-27, leaving questions about the effects of recent key developments, such as an inflation uptick and stalling business activity.

5. FOMC JANUARY MEETING MINUTES

- The recently released minutes from the January FOMC meeting indicate that policymakers are cautious about the current high level of uncertainty in the economy as they chart their course for monetary policy adjustments.
- The meetings showed that many participants suggested that the committee maintain restrictive policy rates if inflation stays hot amid a largely robust economy.
- Conversely, several officials also indicated an inclination to ease rates if labor market conditions weakened, economic growth slowed, or core inflation returned to 2% more quickly.
- Meeting participants noted upside risks to inflation, such as potential shifts in trade and immigration

policies, geopolitical disruptions to supply changes, and stronger-than-expected household spending.

6. DECLINING BUILDER SENTIMENT

- According to data from the National Association of Home Builders (NAHB)/Wells Fargo Housing Market Index, home-builder confidence fell sharply in February, reaching its lowest level in five months.
- According to NAHB Chairman Carl Harris, builders remain hopeful of the prospect of pro-development policies such as regulatory reform, but rising uncertainty is currently dampening expectations for 2025.
- Trade factors again play a role. NAHB points out that 32% of appliances and 30% of softwood lumber comes from imports. The association notably penned a letter to the Trump Administration earlier this month requesting a pause or carve-outs to the proposed tariffs.
- In more positive news, the survey also shows that 26% of builders slashed home prices in February, down from 30% in January and the lowest share since May 2024. However, the average rate of price reduction remains consistently around 5%.

7. HOUSING STARTS DROP

- Housing starts dropped 9.8% month-over-month to an annualized 1.36 million units in January, down from a 10-month high of 1.51 million in December. January's performance missed market forecasts of 1.4 million annualized units.
- Severe snowstorms and freezing temperatures disrupted construction activity in much of the country, while rising costs of imports and mortgages impeded any potential rebound.
- Single-family home starts declined by 8.4% monthly, while multifamily starts fell by a steeper 11.0%.
- Most regions saw starts fall, occurring most significantly in the northeast, down 27.6% from December. The South fell 23.3%, while the Midwest fell 10.4%.

8. CRE CAP RATES RISE

- According to a recent CRED iQ analysis, cap rates in the CMBS shifted towards the end of 2024, with several property types rising on a quarter-over-quarter basis in Q4.

SVN COMMERCIAL REAL ESTATE ADVISORS
svn.com
1309 Beacon St, Suite 300
Brookline, MA 02446

- Office cap rates averaged 7.40% in Q4, up from 7.16% in Q3. Multifamily rates sat at 5.90% on average, slightly increasing from the 5.77% average in the prior quarter.
- Meanwhile, retail sector cap rates averaged 6.70%, up from 6.45% in Q3, while Industrial cap rates averaged 6.40%, up from 6.24%. Smaller property types were mixed, with self-storage cap rates climbing from an average of 5.86% in Q3 to 6.20% in Q4, while hotels fell from an average of 7.80% to 7.30%.
- With valuations trending in an overall positive direction, the uptick in cap rates reflects some upward movement in operating incomes across key sectors.

9. IMPACT OF FEDERAL WORKFORCE CUTS

- Recent cuts to the federal workforce could significantly impact local commerce and commercial real estate in the Washington D.C. area, as explored in a recent analysis by Globe Street.
- Increased layoffs in and around D.C. have largely not shown up yet in unemployment claims data. Roughly 9,500 full-time federal workers and 200,000 probationary workers were laid off on the day before the most recent reporting period began, but initial claims rose just 5,000 above the previous week's level.
- However, initial claims figures are seasonally adjusted and may understate the impact of the federal layoffs. Globe Street found that non-adjusted data actually showed a 4.8% week-over-week decrease in initial claims, but the decline was more tepid than the 6.6% projected by seasonal factors, suggesting layoffs are higher than typical for this time of year.
- Some economists suggest the layoffs could have far-reaching effects, potentially dampening local consumer activity and housing demand while decreasing revenues from national firms that provide or rely on federal services.

10. INDEPENDENT LANDLORD RENTAL PERFORMANCE

- According to the Chandan Economics-Rent Redi Independent Landlord Rental Performance Report, on-time payments to independently operated rental units declined in February, falling by 16 basis points from January to 85.2%.
- Conversely, the forecasted full-time payment rate for February, which estimates the effect of late payments that will be received throughout the month, rose for the first time since October.

SVN COMMERCIAL REAL ESTATE ADVISORS
svn.com
185 Devonshire St, M102
Boston, MA 02110

- Western states continue to experience the highest on-time payment rates nationwide, led by Ohio, Utah, Colorado, New Mexico, and Alaska.
- 2-4 family rental properties and single-family rentals hold the highest on-time payment rates, each at 85.7%

SUMMARY OF SOURCES

- (1) https://taxfoundation.org/blog/permanent-bonus-depreciation-expensing-options/
- https://bipartisanpolicy.org/explainer/the-2025-tax-debate-cost-recovery-provisions-in-tcja/
- (2) https://www.conference-board.org/topics/consumer-confidence
- (3) https://www.pmi.spglobal.com/Public/Home/PressRelease/c3a10cc3461d4d8aa1758082292e7358
- (4) https://pro.morningconsult.com/trackers/household-emergency-expenses-survey
- (5) https://www.federalreserve.gov/monetarypolicy/fomcminutes20250129.htm
- (6) https://www.nahb.org/news-and-economics/press-releases/2025/02/builder-confidence-falls-on-tariff-and-housing-cost-concerns
- (7) https://www.census.gov/construction/nrc/pdf/newresconst.pdf
- (8) https://cred-iq.com/blog/2025/02/21/cap-rate-trends-are-steadily-increasing/
- (9) https://www.globest.com/2025/02/21/federal-workforce-cuts-could-impact-millions-beyond-government-sector/
- (10) https://www.chandan.com/post/independent-landlord-rental-performance-report-february-2025