Economic Update

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MARCH 15, 2024

1. CURRENT ECONOMIC CONDITIONS (BEIGE BOOK)

- According to the March 6th, 2024, release of the Federal Reserve's Beige Book, national economic activity increased over the previous six-week period.
- Eight of the twelve Federal Reserve districts reported slight to modest growth; three indicated soft growth, while one indicated a slight softening of growth.
- Consumer spending ticked down in recent weeks, led by a decline in the sale of retail goods. Further, consumers appear more price-sensitive and have shifted spending away from discretionary goods.
- Air travel was robust during the six-week period, while demand for restaurants, hotels, and other establishments softened as prices entered a seasonal uptick.
- Manufacturing activity was little changed while supply bottlenecks normalized. Delivery delays for electrical components and ongoing disruptions to the Red Sea and Panama Canal shipping continue but have generally not impacted domestic businesses during the reporting period.
- Demand for residential real estate rose during the period as mortgage rates moderated slightly. Commercial real estate activity was comparatively weak, though new demand for data centers, industrial and manufacturing spaces, and large infrastructure projects was notably robust.

2. CRE MARKET SENTIMENT

- A recent market sentiment survey from Bisnow/CohnReznick on CRE operators' focus for 2024 covered industry viewpoints on capital markets, asset classes, geography, and operational outlook.
- A majority of respondents (41%) expect to deploy both equity and debt over the next 1-2 years—37.5% plan to finance mostly with debt, while 21.9% plan to finance with equity.
- According to the report, equity capital availability remains high, but winning and approving deals remain challenging. Private liquidity is plentiful, but matching investor preferences and yield opportunity remains challenging.
- Asset class sentiment is in line with the prevailing story, with multifamily and industrial dominating investor attention while the retail and hotel landscape remain favorable by most metrics. Office deals are getting done with much market-by-market variation, while high-quality build-to-rent developments

continue to draw investor activity.

- Southeast markets continue to lead the charge nationally, particularly in South Florida, North Carolina, and the Nashville metro.
- Operationally, many CRE operators' concerns centered around technological hurdles such as analytics and reporting, cybersecurity, and privacy.

3. WHITE HOUSE EFFORTS TO SUPPORT MANUFACTURED HOUSING

- In its recent press release, the White House announced new efforts to construct more residential units and lower housing costs, with a focus on manufactured housing.
- The administration plans to release $225 in funding to create and preserve manufactured housing communities. The Department of Housing and Urban Development (HUD) recently opened applications for grants to support the effort.
- A new FHA program will also be established to support the manufactured housing sector through financing, including increasing Title 1 Manufactured Housing program loan limits.
- According to a Bisnow analysis, demand for manufactured homes has skyrocketed since the pandemic. Nearly 22 million Americans now live in manufactured homes, and new shipments increased from roughly 94k in 202 to 113k in 2022.

4. SHIFTS IN INTEREST RATE FORECASTS

- Uncertainty surrounding US growth, labor markets, and inflation has complicated rate forecasts in recent weeks and recalibrated futures markets into a more hawkish stance than at the start of the year.
- Entering 2024, there was a near-uniform consensus (88.5%) that the FOMC would issue its first rate cut at its March policy meeting. Expectations have greatly adjusted over the past two months, and as of March 14th, futures markets place the likelihood of a March rate cut at just 1.0%.
- Stronger-than-expected labor market data over the past two months and signs that its effect on consumer demand remains robust have induced the hawkish U-turn. During Q4 2023, real US GDP increased at a 3.2% annual pace, while estimates from the Atlanta Fed's GDPNowcast forecast that the

economy will grow at a 2.3% annual pace in Q1 2024.

5. FEBRUARY JOBS REPORT

- According to the Bureau of Labor Statistics (BLS), the US economy added 275,000 jobs in February, beating estimates for the second consecutive month. Still, some labor market observers note that other indicators have signaled a cooling in market activity.
- The unemployment rate rose 20 basis points to 3.9% during the month, its highest rate since January 2022. Initial jobless claims have consistently beat estimates in recent weeks while wage growth has also slowed, a strong indicator of both labor market loosening and underlying inflation pressures. Further, the number of job openings per unemployed persons continues to decline.
- A sharp increase in construction, retail, and food service jobs propelled the higher-than-expected gain during the month while industries that more typically lead the charge, such as health care, leisure and hospitality, and government, continued to post the most significant monthly increases.
- The mixed signals emanating from February's jobs report are testament to the difficult decisions facing the Federal Reserve ahead: the labor market appears to be moderating, but policymakers need more consistent data to move forward with a shift in interest rate policy.

6. CONSUMER SENTIMENT

- According to the latest estimate, the University of Michigan's consumer sentiment edged lower in February to 76.9 from 79.0 in January. This largely signals that sentiment has held relatively steady in recent months, as the previous three marks for the index have coalesced around this level.
- Expected business conditions are significantly higher than in the fall of 2023, and all components of the index except for one have exceeded their mid-2021 levels, when, notably, pandemic-reopening efforts boosted sentiment numbers.
- Year-ahead inflation expectations edged higher from an expected 2.9% annual inflation rate to an expected 3.0% annual inflation rate. The subtle shift aligns with broader market forecasts over the past month that have moderated the dovish view that price pressures are behind us and rate cuts are

imminent.

- Nonetheless, according to the survey's analysis, shorter run inflation expectations have fallen to the 2.3%- 3.0% range last experienced between 2018 and 2019.

7. FED'S WALLER DOWNPLAYS CRE CRISIS

- In a late February statement, Federal Reserve Governor Christopher Waller said that while risk in commercial real estate is a concern, distress is emerging gradually and is unlikely to cause a crisis.
- Equity cushions could be substantial enough to bear the brunt of potential losses, while according to Paul Fiorilla of Yardi Matrix, the timeline for this development could take 2 to 3 years.
- Waller described the state of market risks as "predictable" and "manageable" and that banks have been preparing for losses, limiting system exposure to potential losses.

8. SPECIAL SERVICING RATES INCREASINGLY DIVERGE

- CMBS Special servicing rates climbed in January to 6.35% after falling slightly in December. It is the highest mark for the CMBS market since October 2021. However, property type performance remains increasingly mixed.
- Most sectors either sustained or amplified emerging trends, furthering the bifurcation of market performance.
- For example, special serving in the multifamily sector dropped sharply in January following more tepid declines to close to 2023. Similarly, following smaller increases in the prior months the office sector rate increased by 129 points. Altogether, three property types experienced absolute changes of 80 bps or more during the month.

9. CPI INFLATION

- According to the latest update from the Bureau of Labor Statistics, consumer prices rose by 0.4% in February and 3.2% over the past 12 months.
- The core Consumer Price Index (CPI), which excludes the more volatile measures of food and energy, also rose 0.4% monthly while charting a slightly higher 3.8% year-over-year.

- Energy and shelter price increases accounted for more than 60% of the total gain in headline CPI as gasoline jumped 3.8% on the month while the shelter measure increased by 0.4%.
- February's CPI report could serve as hawkish fodder for policymakers who are concerned that, despite the reduction of price pressures, inflation remains above the Fed's 2% annual target.

10. EXEMPTING AFFORDABLE HOUSING FROM BOND VOLUME CAPS

- The Federation of American Scientists (FAS) recently looked into the potential for exempting affordable housing projects from volume caps on tax-exempt Private Activity Bonds (PABs).
- The FAS argues that PABs are one of the primary financial tools for building and preserving affordable housing due to their relation to LIHTC financing. It says that lifting caps could speed up the development of badly needed housing.
- Their analysis showed that in 2020, 88% of PAB issuance went to multi- and single-family housing, continuing a decades-long upward trend as affordable housing demand climbs.
- Currently, exceptions exist for activities that contribute to public good, such as critical infrastructure projects

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SUMMARY OF SOURCES

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