



Real Estate Committee Webinar Panel
“Chicago Federal Reserve Real Estate Outlook”
May 22, 2024

CLE Materials and Speaker Biographies

Moderators:

Erin West, Godfrey Kahn

David Levy, Keen-Summit Capital Partners and Summit Investment Management

Panelist:

Martin Lavelle, Senior Business Economist, Federal Reserve Bank of Chicago

Commercial Real Estate

MAY 22, 2024

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FEDERAL RESERVE BANK OF CHICAGO

The views expressed here do not necessarily reflect the views of the Federal Reserve Bank of Chicago or the Federal Reserve System.

FEDERAL RESERVE BANK *of* CHICAGO

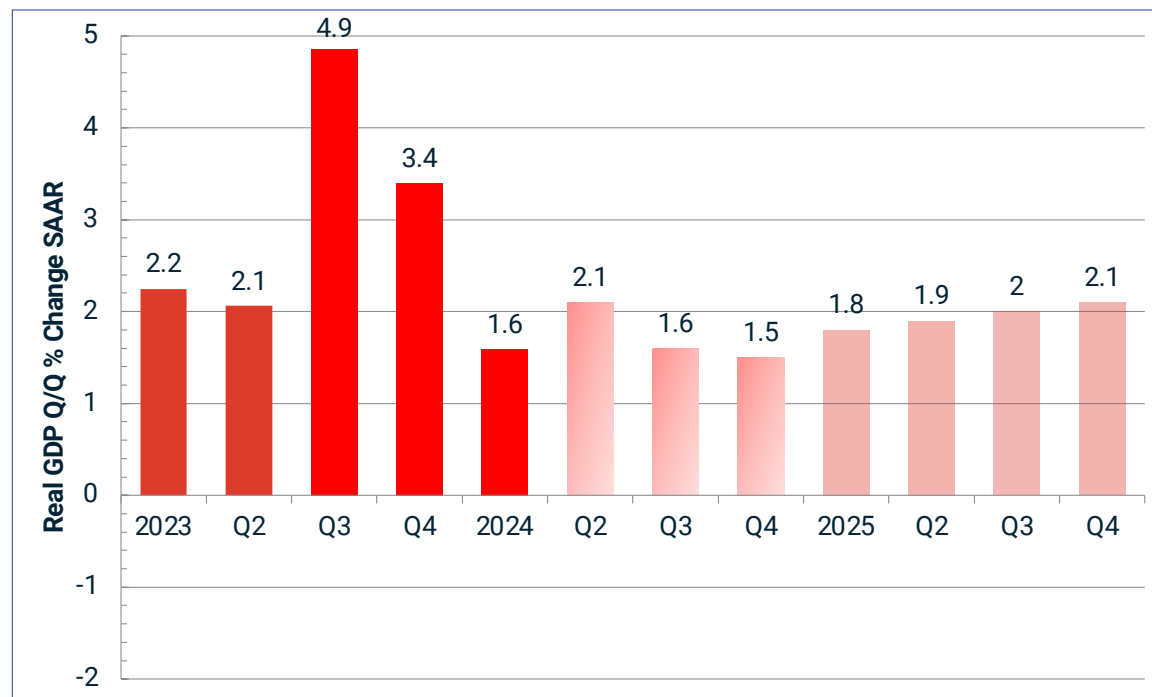
Presentation Highlights

- 1st quarter economic growth was slower but not worrisome.
- Consumer and business sentiment have both softened.
- Inflationary pressures have eased but are pesky.
- There's reason to be worried about CRE, but the question is how worried.
- Where are the trouble spots?

Economic Update

U.S. Real GDP

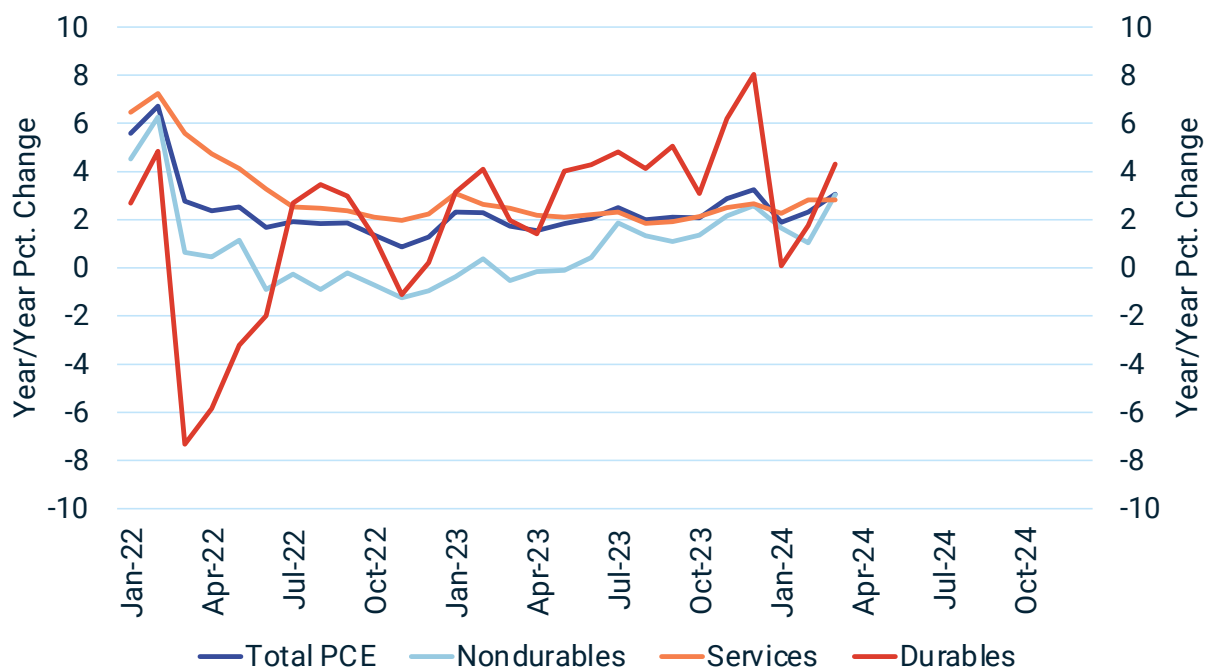
- Real GDP increased 3.2% in 2023. Growth was well above its long-term trend.
- The initial reading of 1st quarter Real GDP growth fell modestly short of expectations
- The most recent Blue Chip consensus forecast expects growth to be much slower this year (1.7%).



Source: Author's calculations using data from U.S. Bureau of Economic Analysis and Blue Chip Economic Forecast.

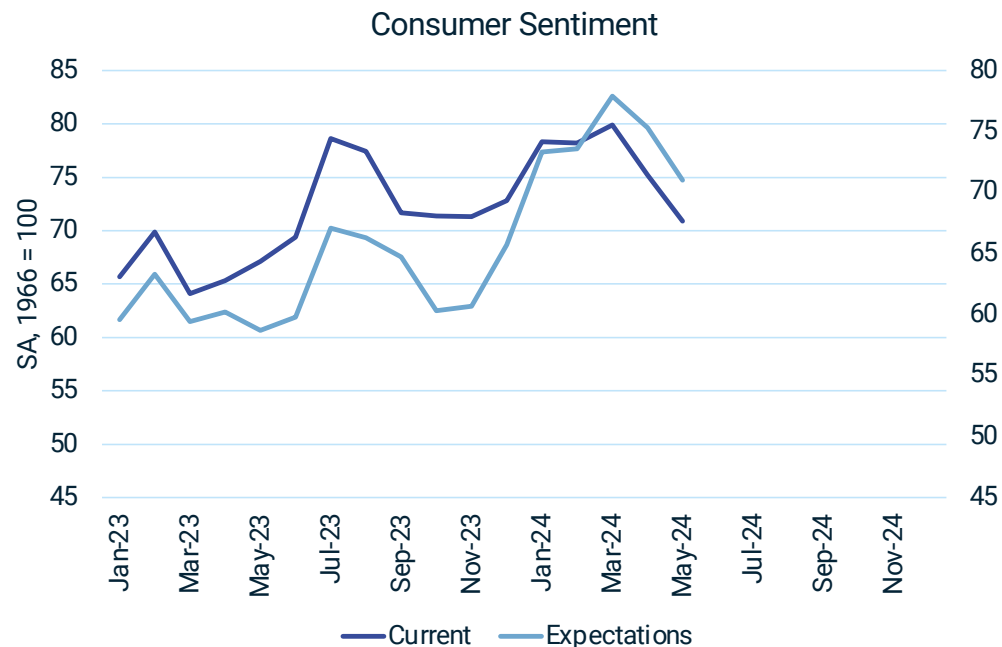
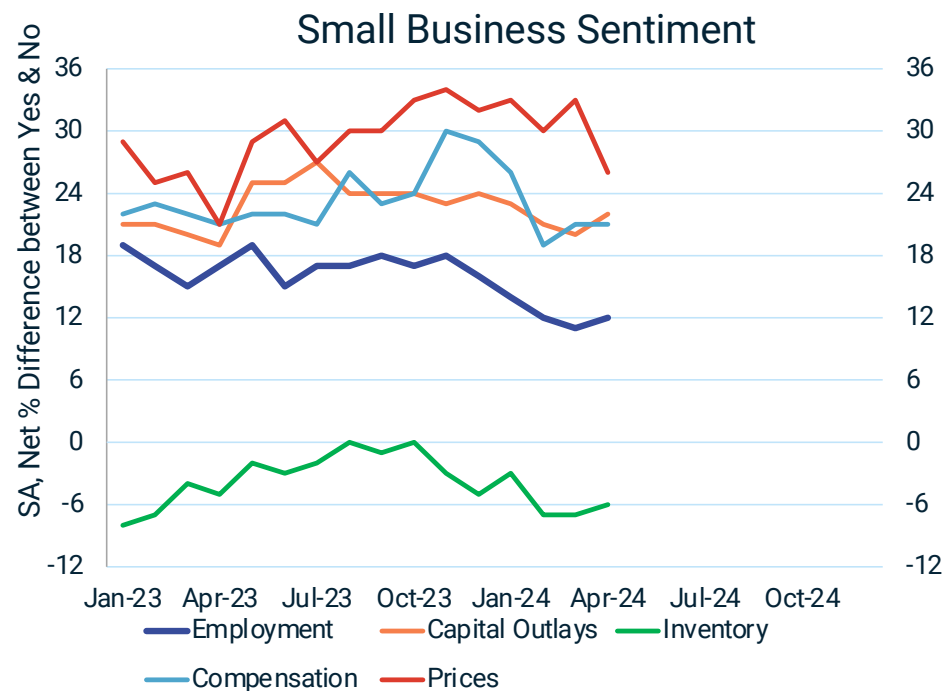
U.S. Real Consumer Spending

- Consumer spending bested expectations in March, though some of that is because of Easter
- When you look at the quarter/quarter change, spending growth isn't quite as strong, notably on the goods side



Source: Author's calculations using data from U.S. Bureau of Economic Analysis

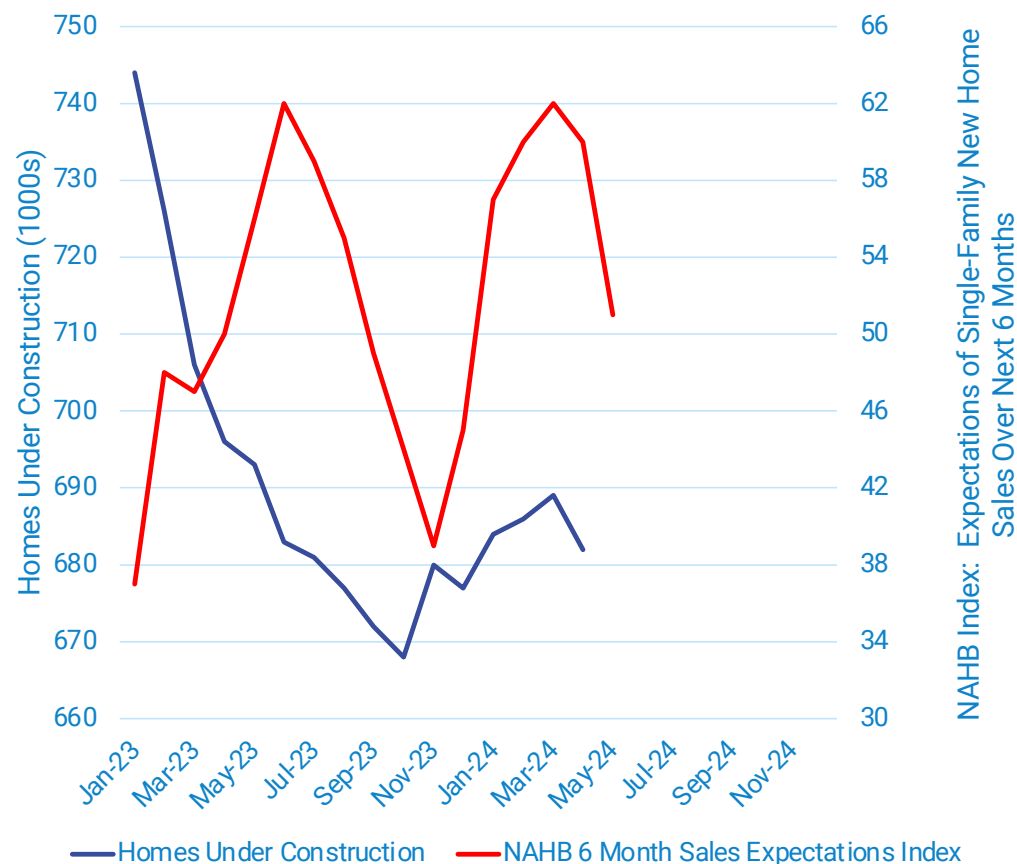
Consumer Sentiment Has Improved



- Consumer sentiment rose in the 1st quarter but has retreated since.
- Small business optimism is near its post-COVID low and the business metrics are reflecting that as well.

Single-Family Homes Under Construction and New Home Sales Expectations

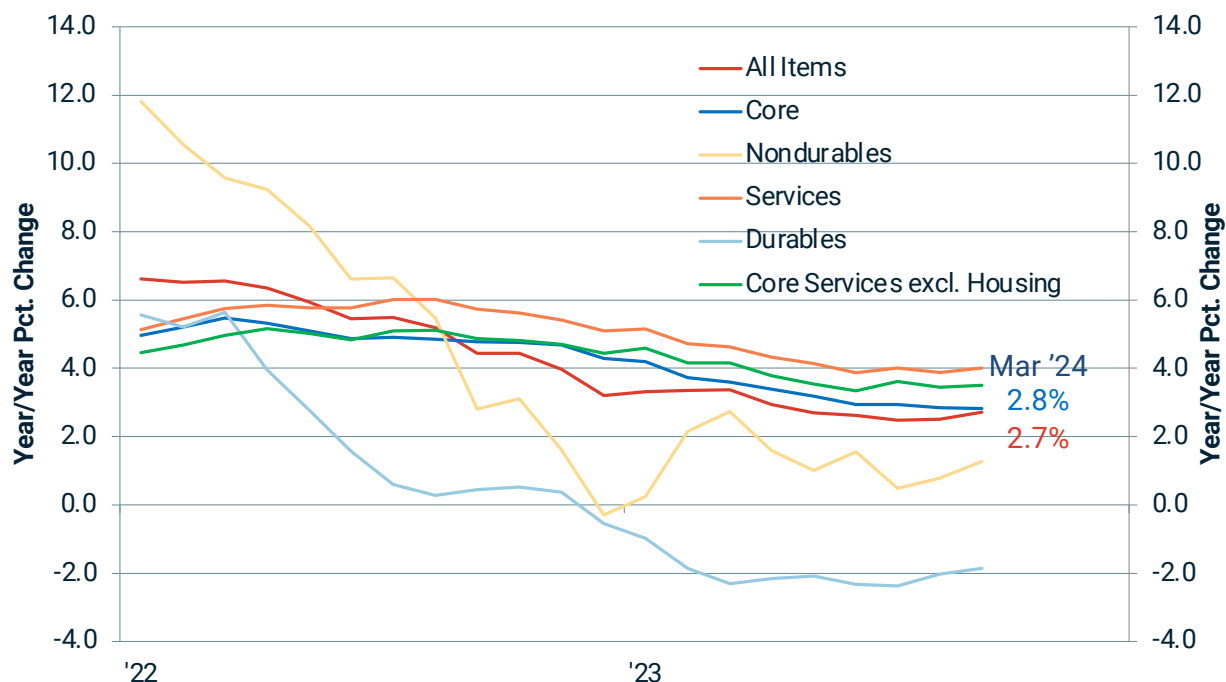
- The number of single-family homes under construction have noticeably fallen from last spring's peak
- Homebuilder optimism has been volatile since last summer



Inflation

PCE Inflation

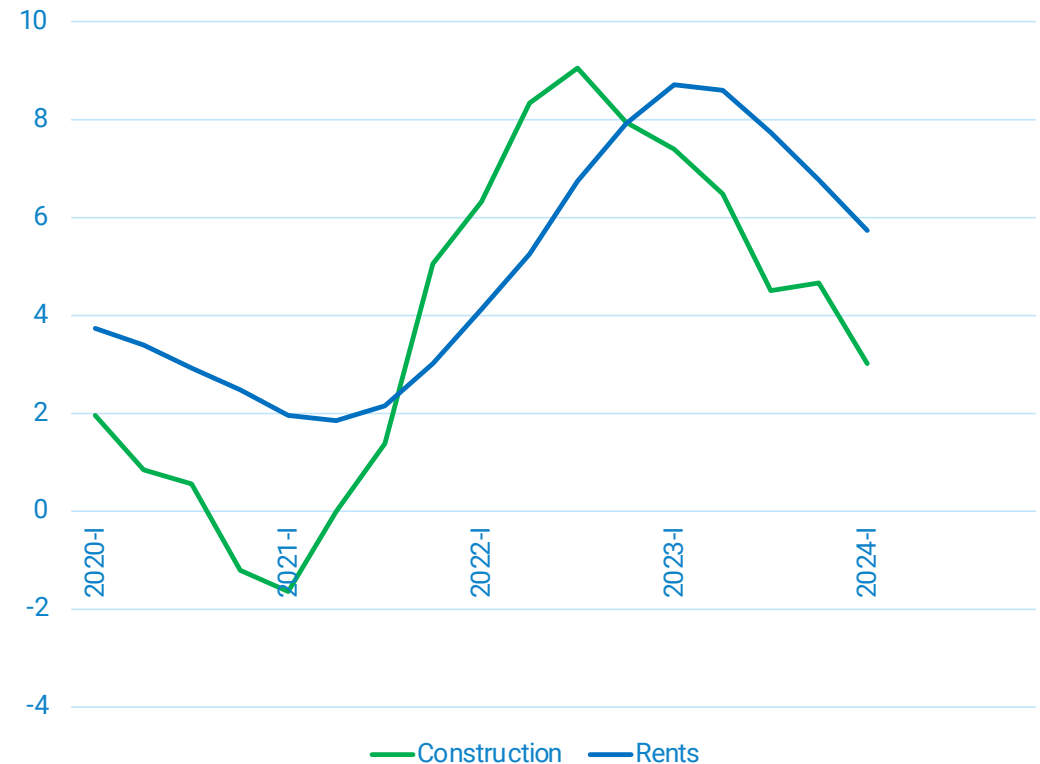
- Headline PCE inflation increased, largely because of higher gas prices than at this time last year
- Core PCE inflation held steady as pricing in some services remain stubborn
- Slower price increases continue to show up in food, clothing, and housing



Source: Author's calculations using data from the Bureau of Economic Analysis

Multifamily Inflation: Construction vs. Rents

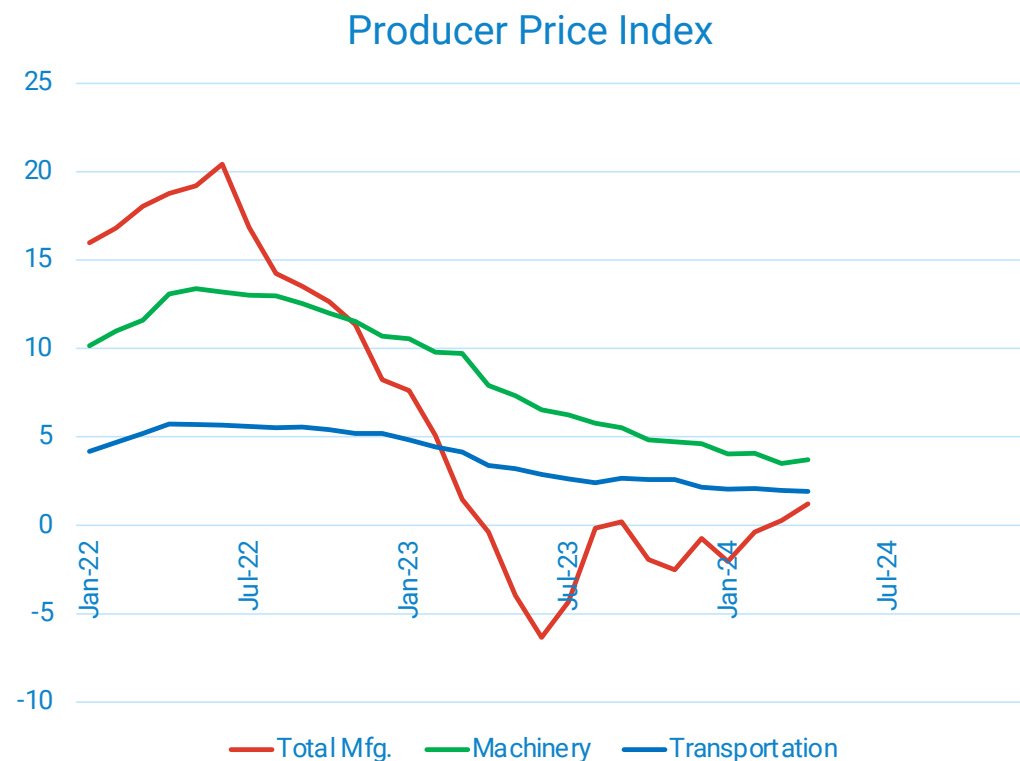
- Construction: Constant Quality (Laspeyres) price index
- Rents: BEA
- Zillow rents showing a 1st-quarter rebound



Source: Author's calculations using data from the Census Bureau, Bureau of Economic Analysis and Haver Analytics

Machinery Manufacturing Inflation

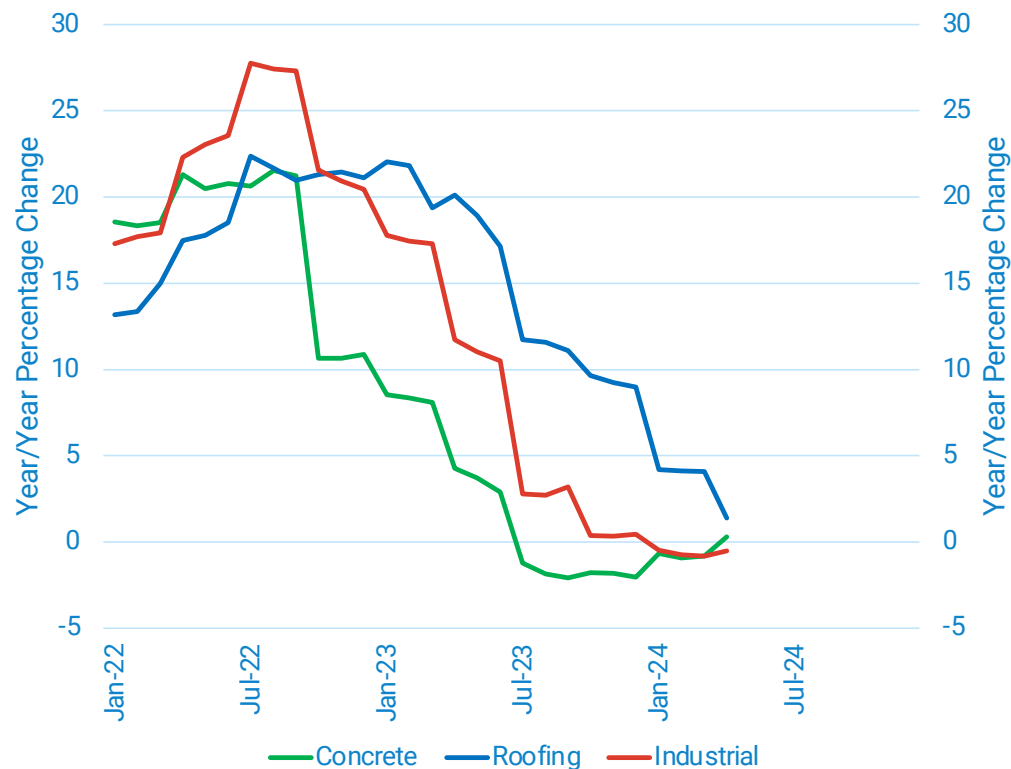
- Inflationary pressures have eased on the production side
- Ag and industrial machinery have come way down from their COVID peaks



Source: Author's calculations using data from the Bureau of Labor Statistics and Haver Analytics

New Building Inflation

- Inflationary pressures have eased
- But they've eased at high price levels



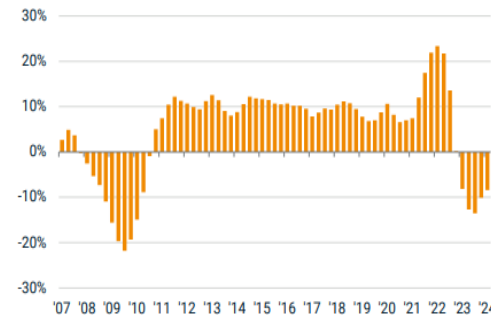
Source: Author's calculations using data from the Bureau of Labor Statistics and Haver Analytics

General State of Commercial Real Estate

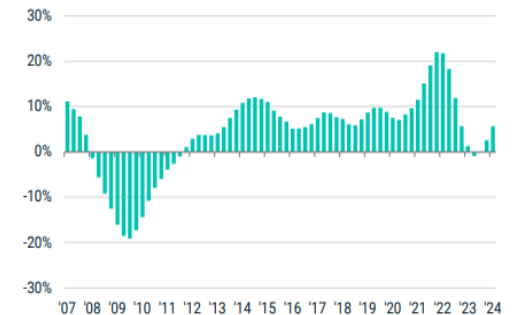
Commercial Property Prices

- When looking at the year/year change in property prices, the largest decreases are in multifamily and office.
- For office, it's becoming increasingly common to hear of properties that have seen values fall 30-40% from their peak

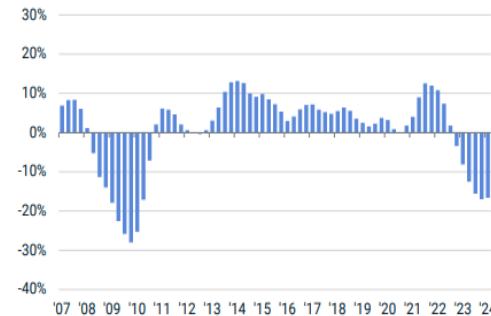
Apartment



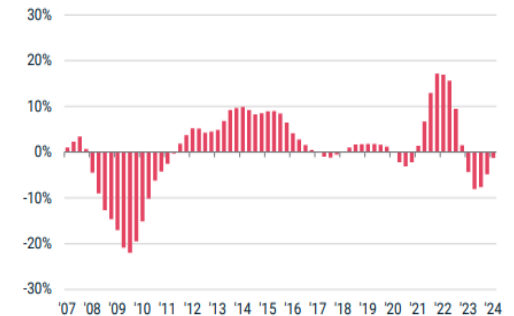
Industrial



Office



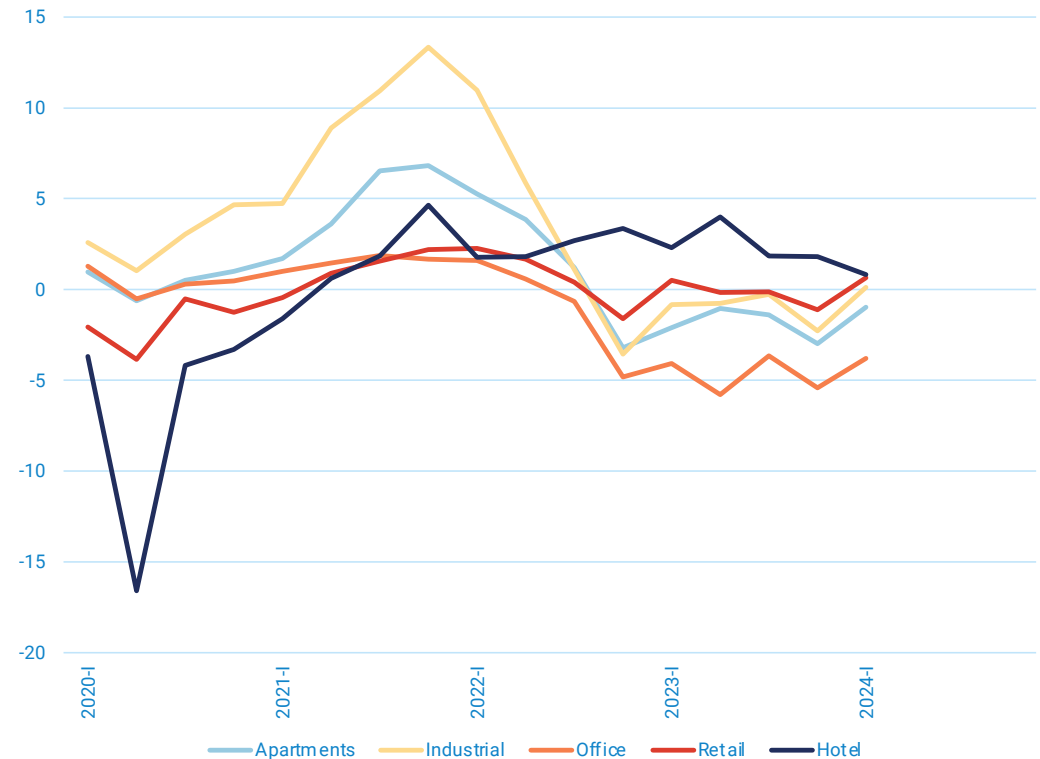
Retail



Source: MSCI Mortgage Debt Intelligence

Real Estate Rates of Return

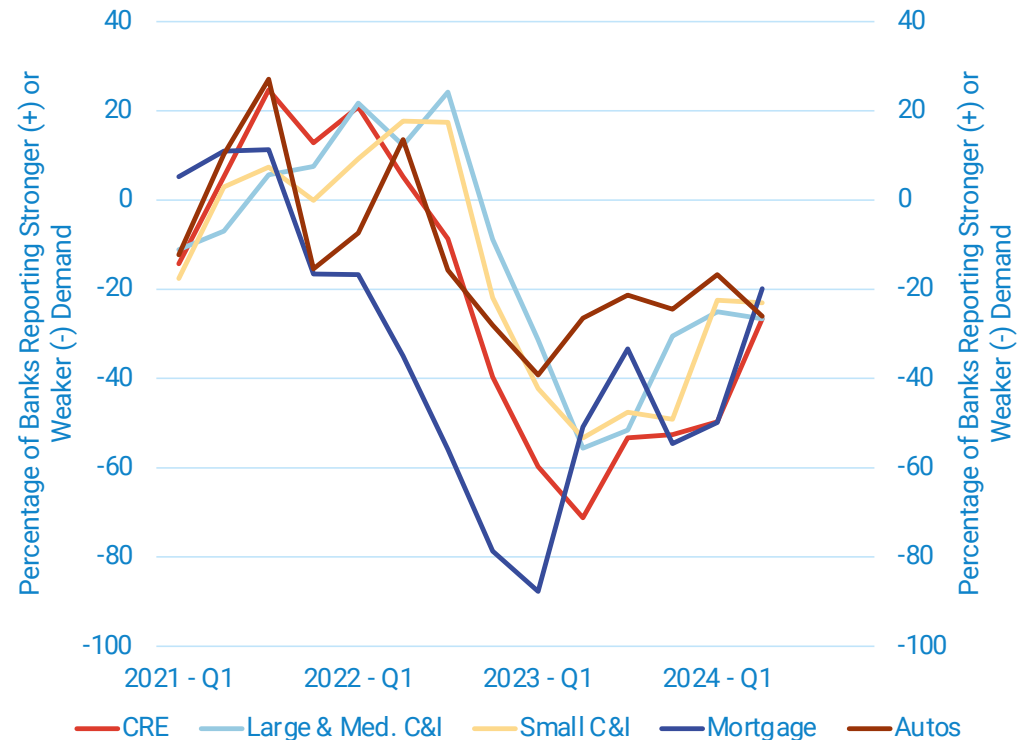
- Rates of return have dipped and are well off pre-COVID levels
- The rates of return lag Treasuries as well



Source: NCREIF and Haver Analytics

Senior Loan Officer Survey

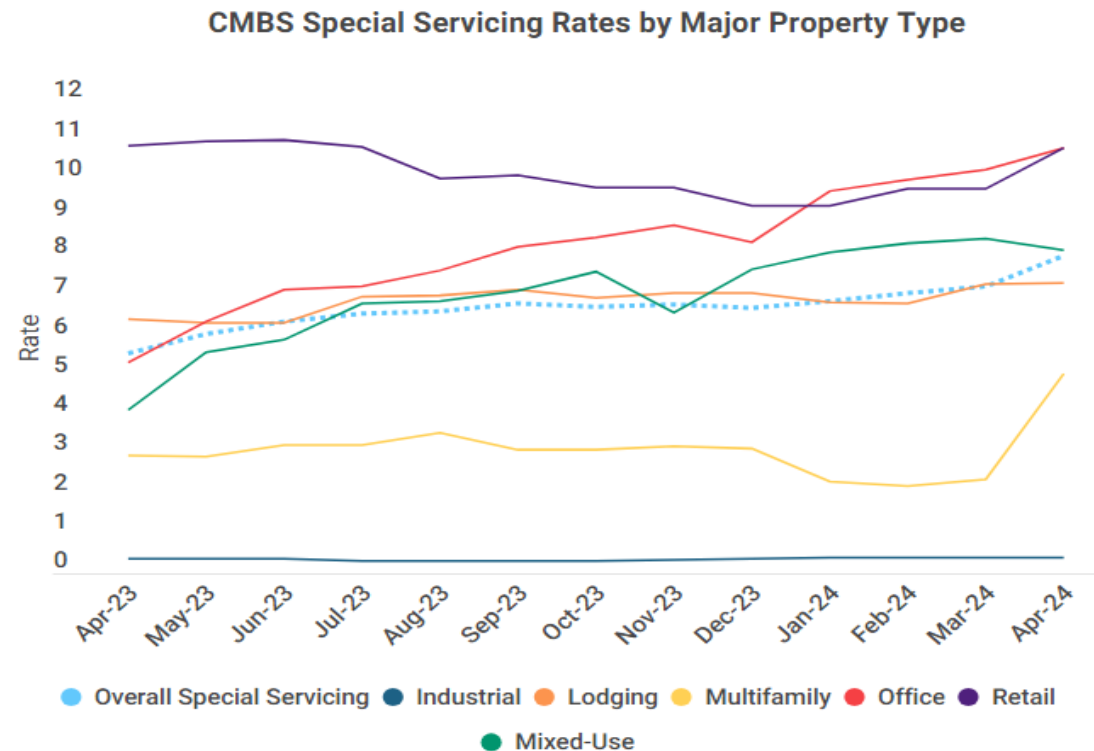
- Loan demand continued to weaken at a similar pace according to the most recent survey
- Demand for auto loans was relatively weaker than the other categories in the most recent round
- The pace of weaker demand in mortgages has slowed the most



Source: Federal Reserve Board/Haver Analytics

CMBS Special Servicing Rates by CRE Sector

- An increase in special servicing correlates with an increased risk of default
- Office and mixed-use properties have seen the most noticeable increases in special servicing rates



Source: Trepp

CRE Sectors With Upside

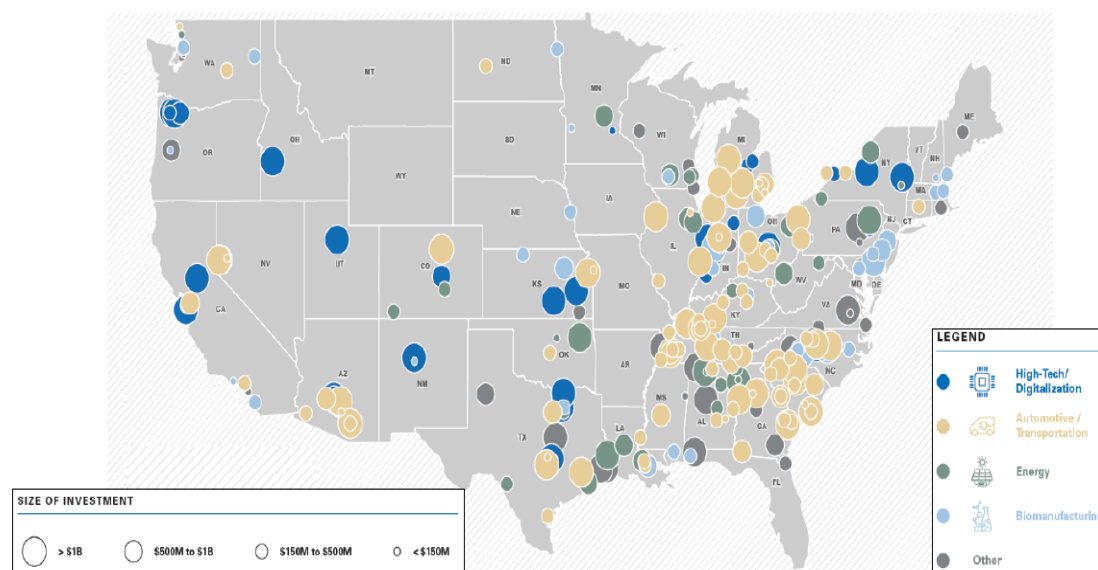
Industrial Market Overview

- The number of significant manufacturing announcements + the potential of nearshoring = an opportunity for additional growth in industrial
- In the near-term, construction is cooling off back to its pre-COVID trend, along with rent growth.

Monumental Growth in Domestic Manufacturing is Underway

A snapshot of initial manufacturing investments totaling a minimum of \$100 million since 2020 reveals approximately \$400 billion in investments pledged, 210,000+ new jobs and a minimum of 250 MSF of new industrial projects to come between now and 2030. Four key advanced manufacturing sectors are driving the greatest volumes of investment and development, capturing over 90% of the major investments pledged: High-tech/digitalization, Automotive/transportation, Energy, and Biomanufacturing.

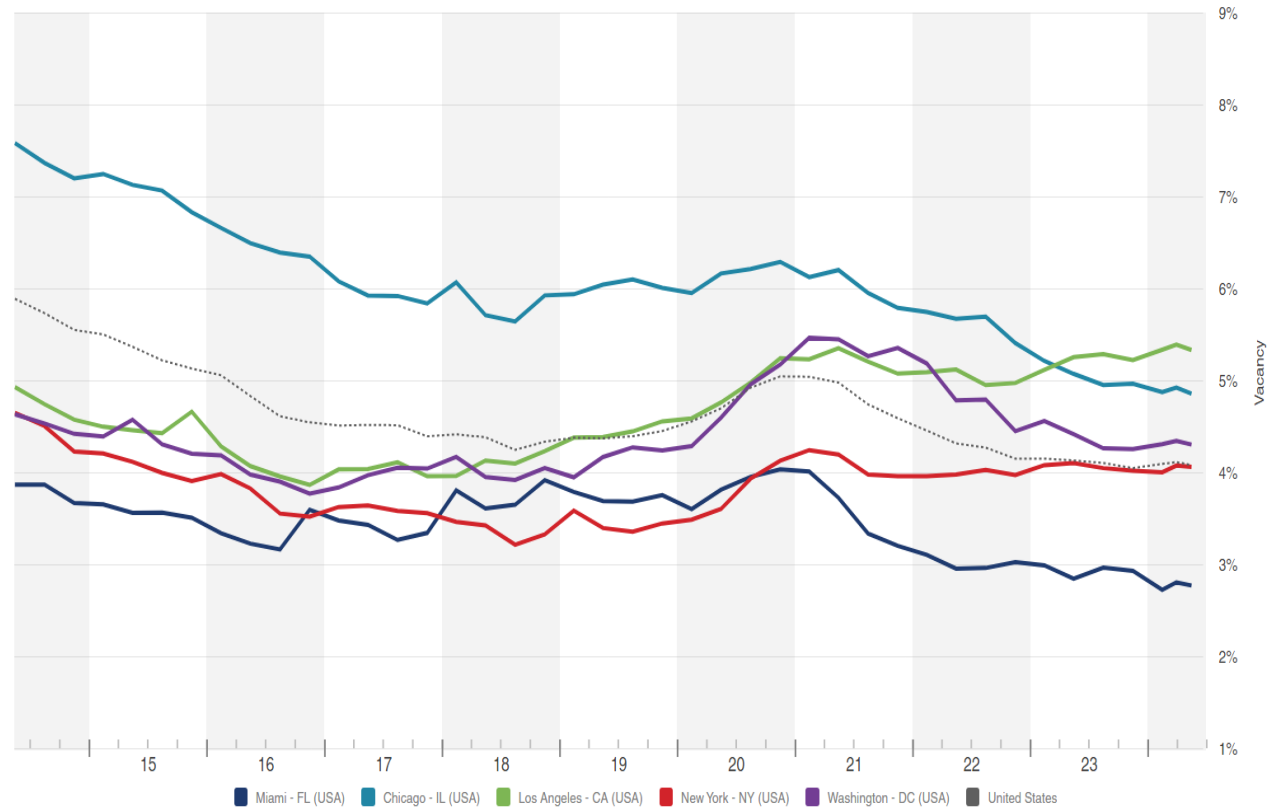
U.S. Major Manufacturing Announcements, 2020-2023



Note: Investments of at least \$100 million. Investment dollars may include allocations to real estate and equipment, infrastructure, intellectual property, and other outlays.
Sources: Newmark Research, Newmark Global Strategy & Consulting, various press releases and articles

Retail Vacancy Rates

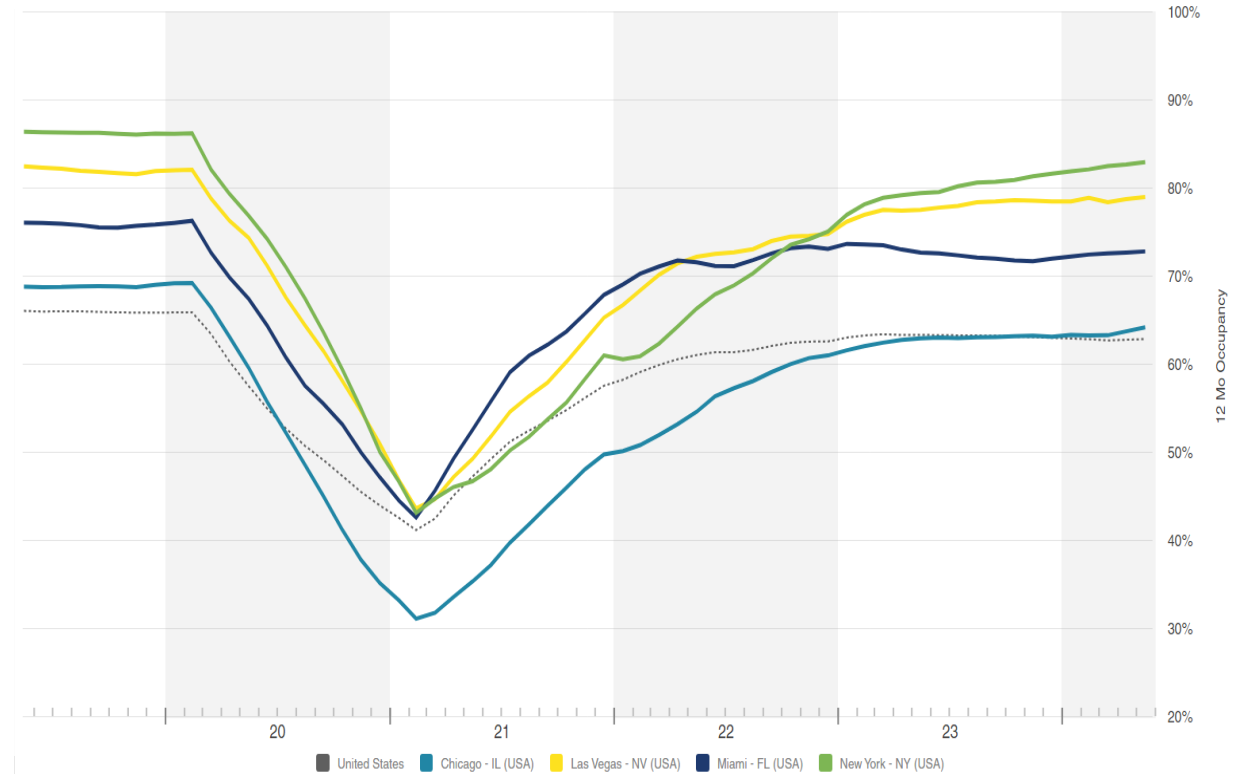
- COVID ended up being retail's reset
- Prime locations with infill opportunities are in demand
- Especially those that are grocery-anchored



Source: CoStar

Hospitality Occupancy Rates

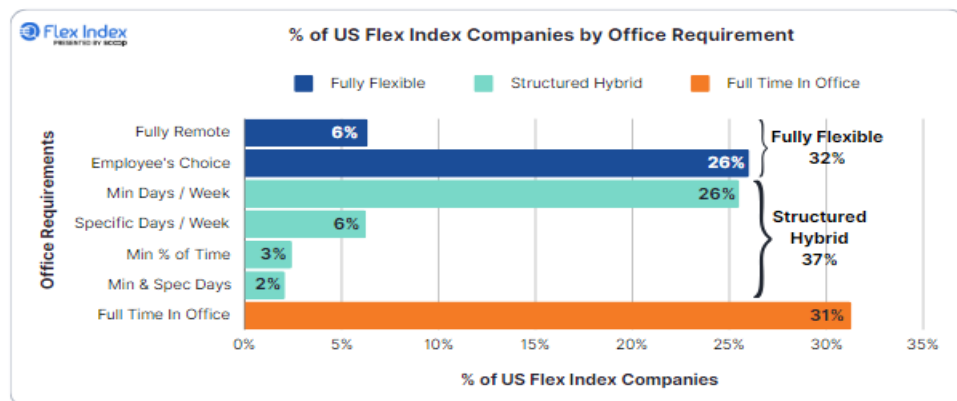
- Occupancy rates remain slightly to modestly off pre-COVID levels
- This hasn't caused a decrease in hotel room supply
- But new construction is moderately off pre-COVID levels



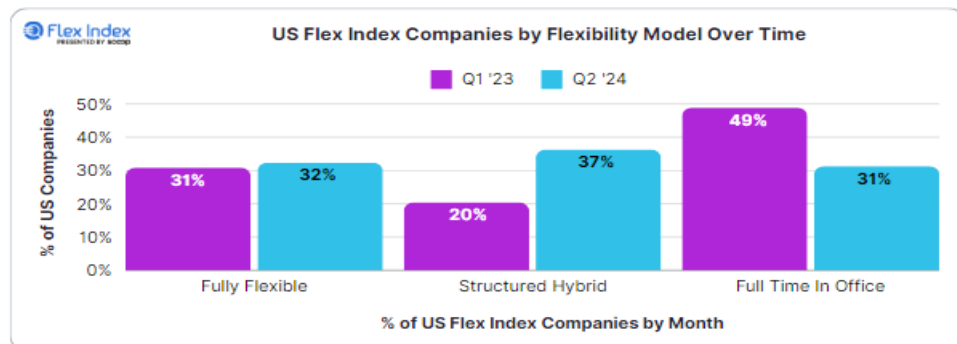
Source: CoStar

Troubled Markets: Office and Multifamily

Pandemic Effects on Working



Source: [Flex Index](#) (flex.scoopforwork.com) employer-provided policy data and publicly available data on company office requirements for companies with headquarters in the US, N = 5,863 companies. Flex Index data has been re-weighted using the Current Population Survey industry data to better approximate the US working population. The Flex Index is presented by [Scoop](#) (scoopforwork.com).

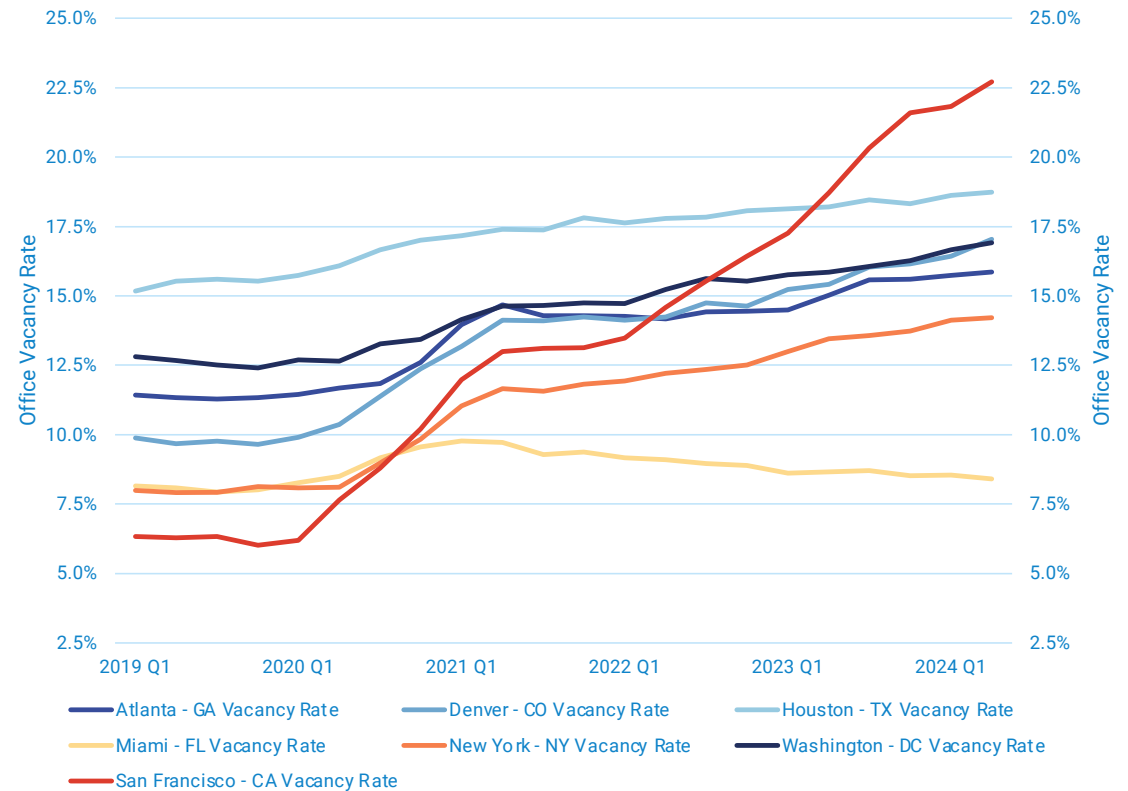


Source: [Flex Index](#) (flex.scoopforwork.com) employer-provided policy data and publicly available data on company office requirements for companies with headquarters in the US, N = 5,863 companies. Flex Index data has been re-weighted using the Current Population Survey industry data to better approximate the US working population. The Flex Index is presented by [Scoop](#) (scoopforwork.com).

There continues to be some talk of a more aggressive return to office policy by some employers in 2024. However, employer surveys continue to show that the ideal number of days employers would like employees to be in the office was 2-3 and fewer employers are asking for a full-time return to the office.

A Look At Some Individual Office Markets

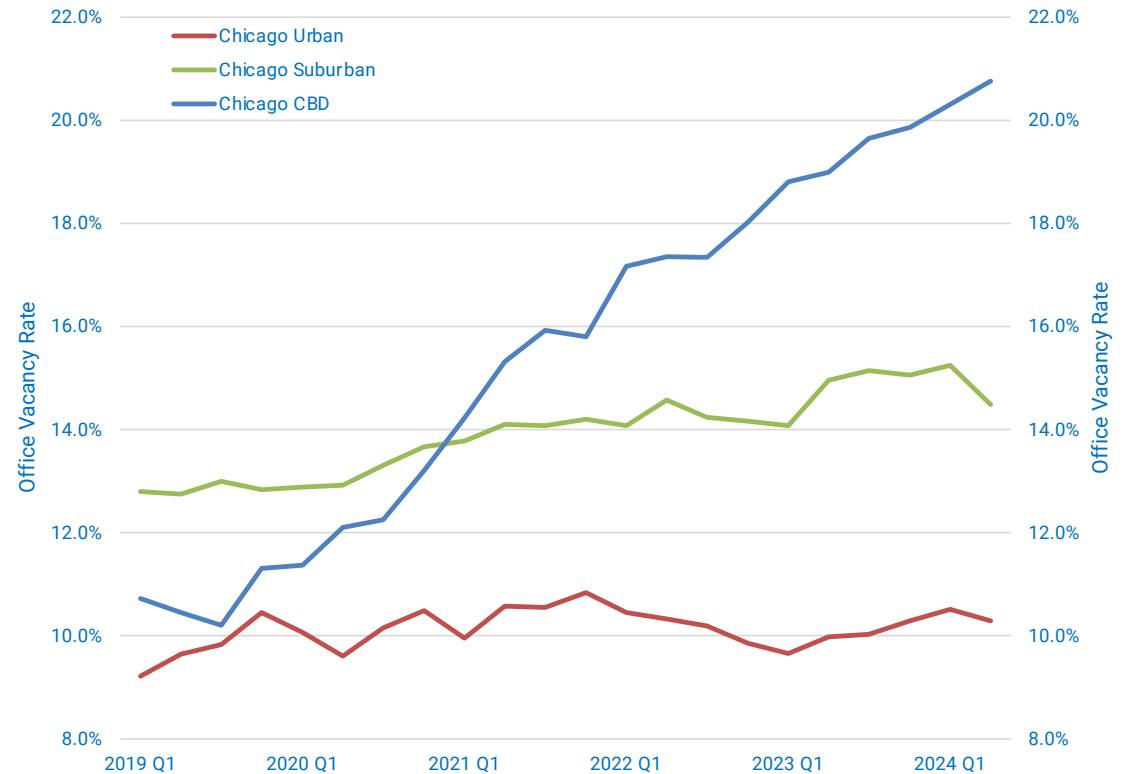
- San Francisco's vacancy rate continues to rise
- Washington DC's office market has some challenges
- There's more optimism around NYC's market?



Source: CoStar

Chicago Office Market

- The Chicago market is challenged to say the least.
- There will be some conversions, but they'll be expensive.



Source: CoStar

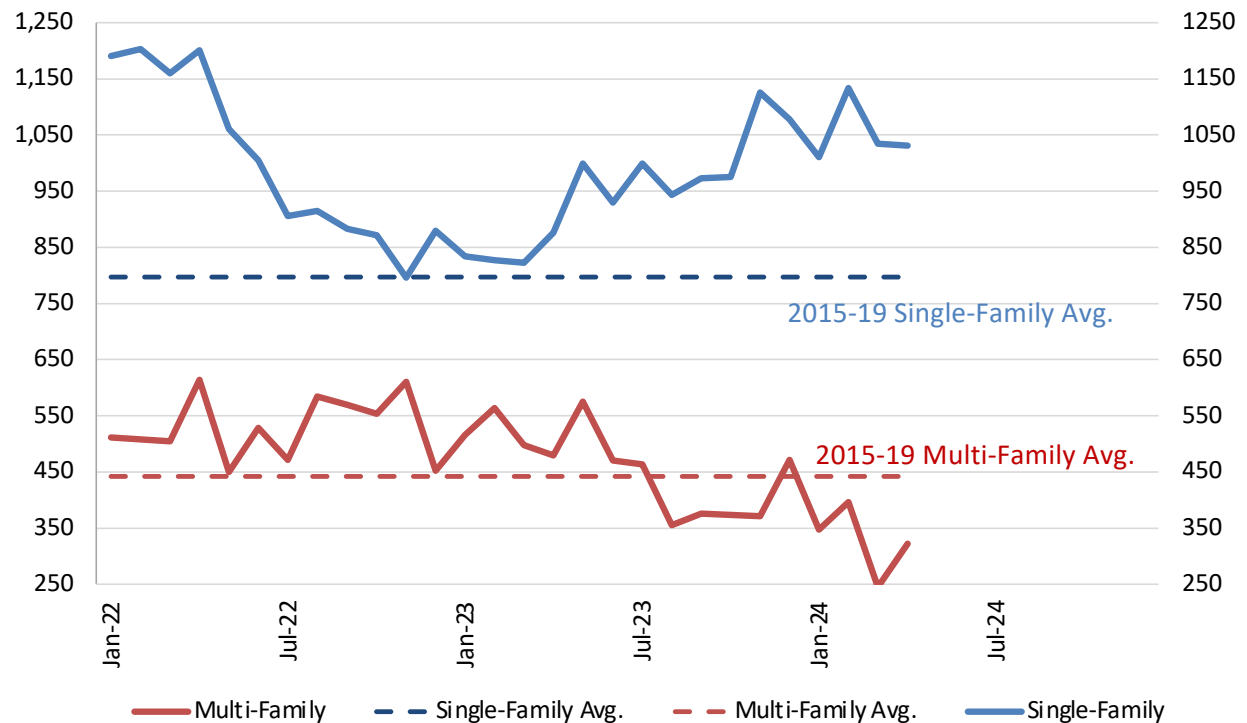
Office to Multifamily Conversions?

- Using the Moody's analysis and CoStar data, here's what I found for Detroit and surrounding areas
 - > 30% vacancy rate
 - < apartment asking rent (\$15/SF for surrounding areas and Detroit City, \$21/SF for Detroit CBD)
 - < 14,000 SF floor plate
- Detroit CoStar Market (closer to Detroit CBSA)
 - 9932 existing office properties
 - 133 fit the criteria
- Detroit City
 - 897 existing office properties
 - 10 fit the criteria
- Detroit CBD (Downtown, Midtown, New Center)
 - 273 existing office properties
 - 4 fit the criteria
- Extensive subsidies would be needed
- However, Detroit's done its fair share of conversions

Sources CoStar and Moody's Analytics: [Moody's Analytics CRE | Why Office-to-Apartment Conversions are Likely a Fringe Trend at Best \(moodyanalytics.com\)](https://www.moodyanalytics.com/insights/office-to-apartment-conversions-are-likely-a-fringe-trend-at-best)

U.S. Housing Starts: Single-Family vs. Multi-Family

- Single-family starts have remained robust despite higher mortgage rates and higher costs
- Multi-family starts were already at historical highs leading into the pandemic

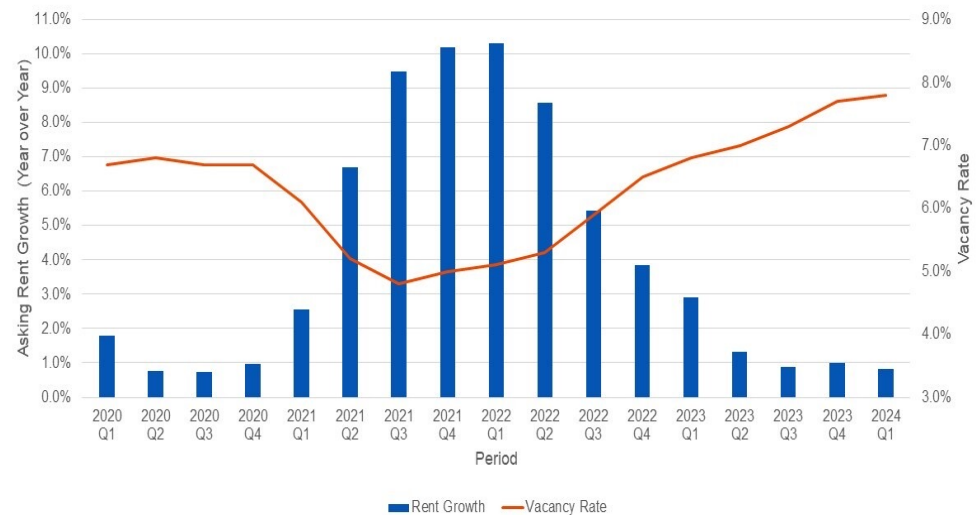


Source: Author's Calculations Using Data From the U.S. Census Bureau

Multifamily Rent Pressures

- The vacancy rate will be volatile given with so much supply coming on the market in the next 12-18 months
- Rent growth has stabilized but is supply-dependent

Multifamily Vacancy and Rent Growth Appear to Be Stabilizing



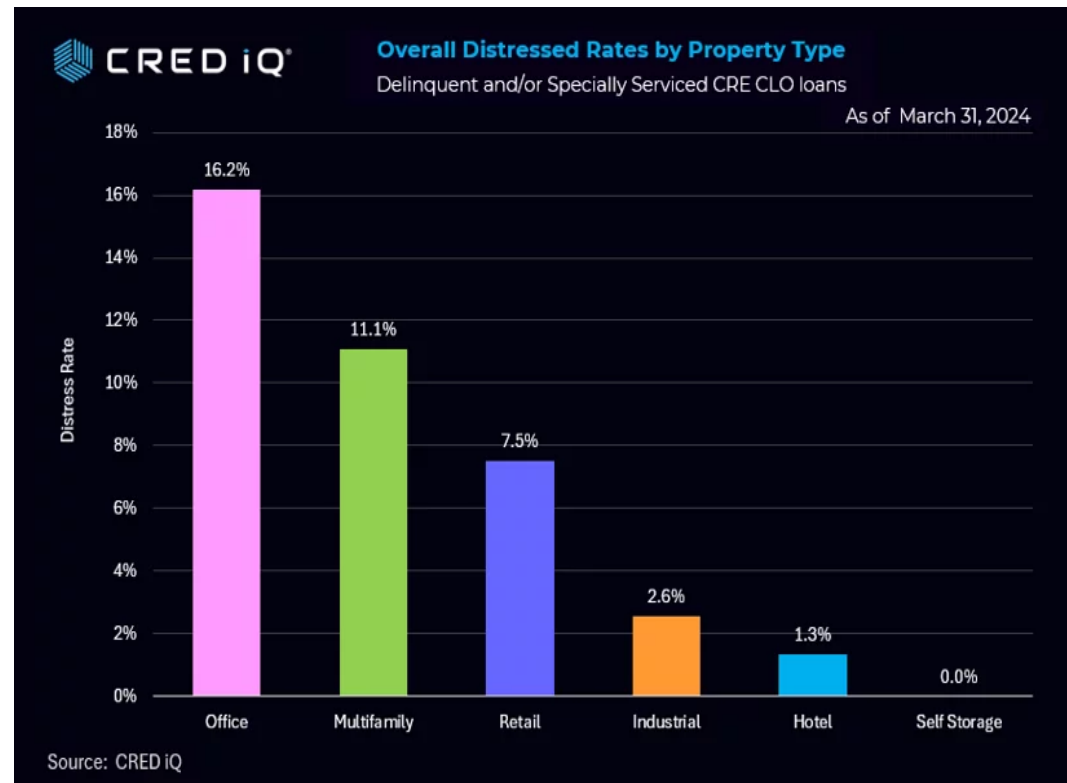
Source: CoStar, April 2024



How the Maturity Wall is Evolving

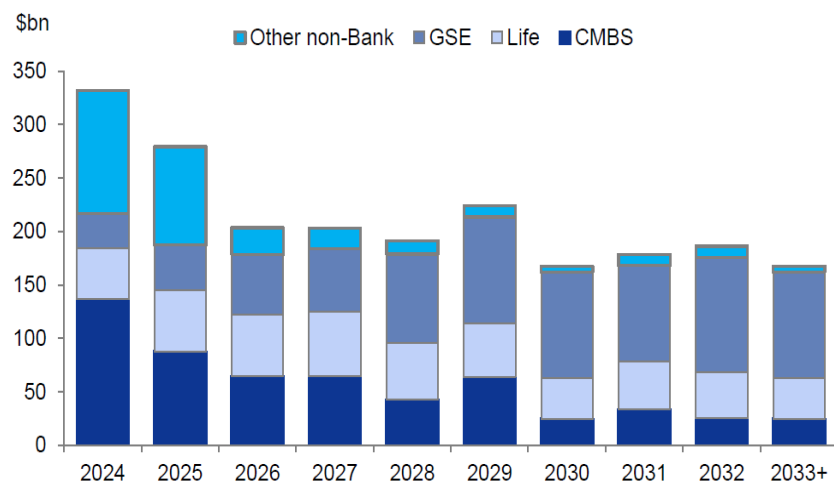
Distressed Rates

- According to CRED IQ, the overall distressed rate for CLOs is 10.2%.
- 44% of distressed loans have matured so they'll be modified further?



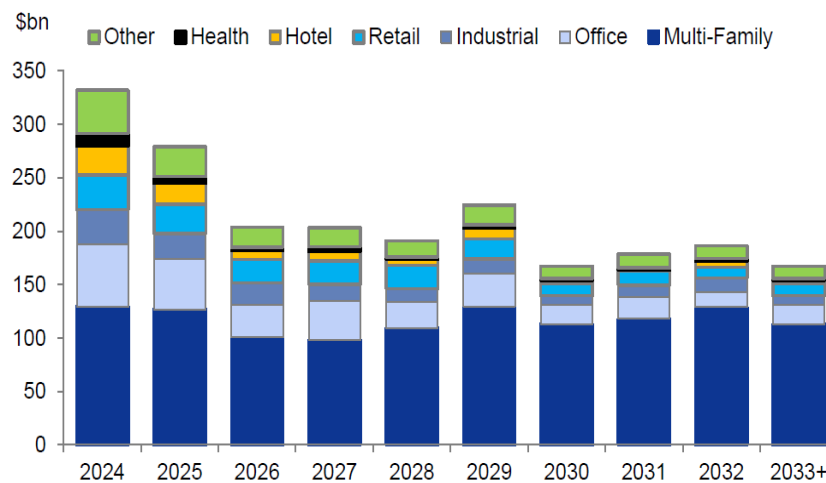
Debt Maturity Schedule

Exhibit 22: CRE loan maturity schedule by non-bank lender type (\$ bil)



Source: Mortgage Bankers Association, Goldman Sachs Global Investment Research

Exhibit 23: CRE loans maturity schedule by property type (\$ bil)

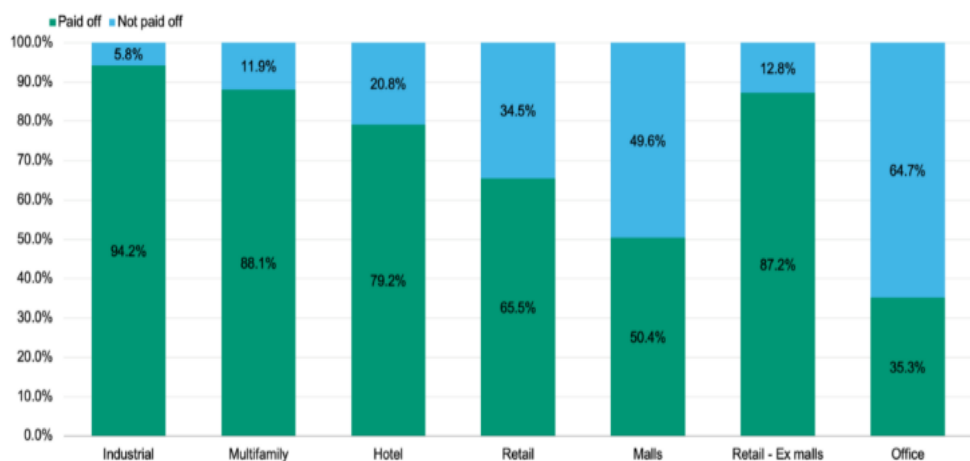


Source: Mortgage Bankers Association, Goldman Sachs Global Investment Research

- The 2024 and 2025 columns keep getting larger as modifications become more common.
- CLO maturities are also mostly concentrated in 2024 and 2025

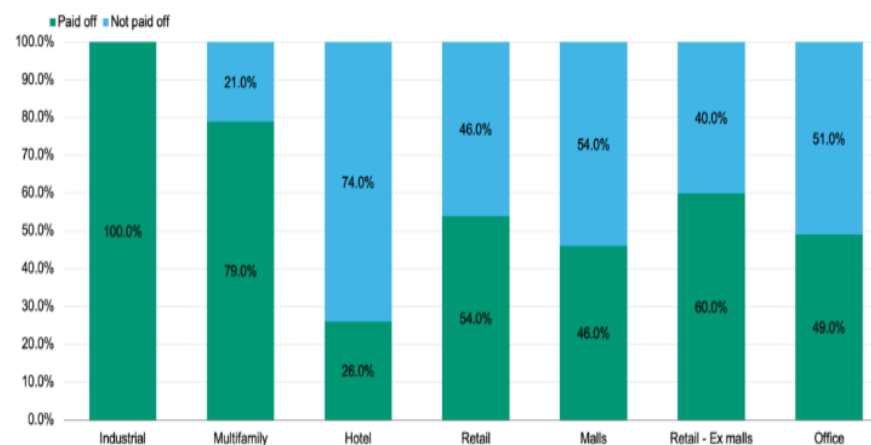
Maturity Payoff Rates

Chart 5: YTD Payoff Rate of Major Property Types through 12/31/2023



Sources: Moody's Analytics CRE, data via Moody's Analytics CMBS

Chart 5: YTD Payoff Rate of Major Property Types through 3/31/2024

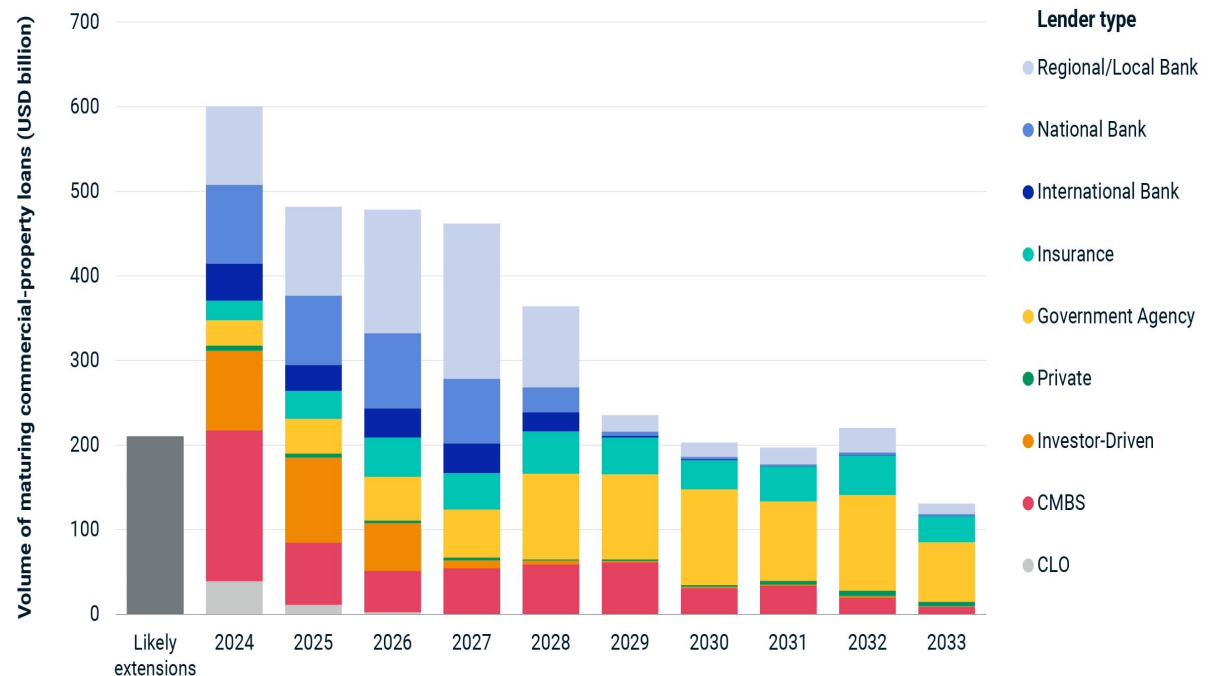


Sources: Moody's CRE, data via Moody's CMBS

- Improvement in office?
- The impact of higher rates being felt?

The Maturity Wall by Lender Type

- Besides CMBS, the exposure regional banks have stands out.
- Most of the banks with the highest concentration of office loans have 20-30% scheduled to mature this year and another 15-25% in 2025



Source: MSCI Mortgage Debt Intelligence

What 2024 Will Hinge On

Consumer Firepower
Consistent Wage Pressures
Low Unemployment
Locked-In Low Mortgage Rates

Decreasing Inflation Rate
Steady Commodity Prices
Anchored Inflation Expectations

Will consumers keep it up?
Will the labor market retain its strength?
What if interest rates stay higher for longer?

Interest Rate Pressures
Rising Delinquencies
Office and Multifamily CRE Concerns
Restraints on Single-Family Housing

Geopolitical Risks
Downward Trend in Orders and Backlogs
Shipping and Logistics Disruptions
Election Anxiety

CRE Summary

- There are CRE sectors faring well.
- Credit is available
 - But hard to access, especially in office and multifamily
 - Financing new construction and the equipment needed for it is difficult as well
- Elevated construction material and labor costs aren't helping new projects get off the ground
- Extend and pretend is happening and is likely to continue
- Higher interest rates for longer won't help the situation



www.chicagofed.org



Martin Lavelle

Senior Business Economist

[E-mail](#)

Biography

Martin Lavelle is a senior business economist in the research department at the Federal Reserve Bank of Chicago's Detroit Branch. Mr. Lavelle's job responsibilities include economic research, education, and outreach. His research revolves around the Michigan economy and its impact on the Seventh District and national economies, respectively. Specific topics include, but aren't limited to, the auto industry, construction and real estate, consumer spending, rural economic development, and the City of Detroit. Mr. Lavelle is heavily involved in the formulation of the Chicago Fed's [Beige Book](#) submission by moderating roundtables of key business contacts and regional stakeholders across Michigan and Indiana. Mr. Lavelle has contributed numerous *Fed Letters* and articles for the Michigan and Midwest blogs.

Mr. Lavelle served on the Detroit Post-Bankruptcy Working Group, updating policymakers and advisors on economic developments. In addition, he speaks to economics classes at area colleges and high schools. In 2012, he began a series of evening workshops for teachers and educators entitled "Night at the Fed," in which attendees learned more about economic entities and concepts that can be incorporated into classrooms and seminars. In addition to his Federal Reserve work, Mr. Lavelle has taught managerial economics at the University of Michigan-Dearborn and volunteered with Junior Achievement, teaching high school students about entrepreneurship. Mr. Lavelle received his B.S. in Business and M.A. in Economics from Miami University in Oxford, OH.



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Practice Areas

Business Finance,
Bankruptcy & Restructuring

Contract/Commercial

Admissions

Minnesota

Wisconsin

Education

Juris Doctor, University of
Minnesota Law School,
2009, *cum laude*

Bachelor of Science,
University of Wisconsin-
Madison, 2006



Erin has more than ten years' experience helping lenders, trade vendors, committees, debtors, buyers, and other creditors navigate all facets of insolvency, bankruptcy, and financial distress. This includes pre-bankruptcy advising and workouts, bankruptcy, and state court receivership proceedings. Recent experience includes:

- Negotiation of loan renewals, refinancing, and forbearance agreements;
- Litigation and resolution of cash collateral use, adequate protection, debtor-in-possession financing, critical vendor status, reclamation claims, executory contract and lease disputes, claims objections, automatic stay litigation, and dischargeability and avoidance actions;
- Representation of secured and unsecured creditors in commercial collections, foreclosures, and other complex commercial litigation matters including state and federal appeals;
- Asset sales and auctions through receivership or bankruptcy proceedings;
- Representation of Fee Examiners and Fee Committees in large Chapter 11 bankruptcies, through qualitative and quantitative analysis of fee applications and negotiation and litigation of disputes. Recent representative fee review engagements include: *In re Energy Future Holdings Corp., et al.*, *In re The Commonwealth of Puerto Rico, et al.*, and *In re Samson Resources Corp.*

Prior to joining Godfrey & Kahn, Erin practiced bankruptcy and commercial litigation at a Madison law firm for five years, where she frequently appeared as counsel for a Chapter 7 panel trustee. While a student at the University of Wisconsin – Madison, Erin was a member of the women's crew team. In her free time, she continues to enjoy competitive rowing.

Court Admissions

United States District Court, Central District of Illinois
United States District Court, Northern District of Illinois
United States District Court, Southern District of Illinois
United States District Court, Southern District of Indiana
United States District Court, Northern District of Indiana
United States District Court, District of Minnesota
United States District Court, Eastern District of Wisconsin
United States District Court, Western District of Wisconsin
Third Circuit Court of Appeals
Seventh Circuit Court of Appeals

Professional Association Memberships

American Bankruptcy Institute
International Women's Insolvency and Restructuring Confederation
Western District of Wisconsin Bankruptcy Bar

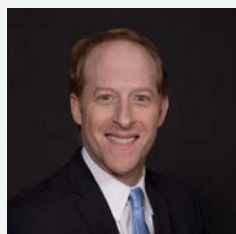
Activities

American Bankruptcy Institute – Special Projects Leader, Real Estate Committee
Madison South Rotary Club – Board of Directors
Western District of Wisconsin Bankruptcy Bar – Treasurer, Past Chair

Honors

American Bankruptcy Institute *40 Under 40* (2022)
Recognized by *Super Lawyers* as a *Wisconsin Rising Star* (2011 - present)
Recognized by *Best Lawyers* "Ones to Watch" (Bankruptcy and Creditor Debtor Rights/Insolvency and Reorganization Law, 2021 - present)

David Levy



David Levy

Managing Director

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Web www.Keen-Summit.com

David is head of the Summit Investment Management and Keen-Summit Capital Partners Chicago office. He responsible for all aspects of business development and execution in connection with the company's distressed debt acquisitions and opportunistic credit transactions, plus real estate brokerage and auction, investment banking, and lease modification and restructuring services. David has more than 13 year's experience in real estate advisory and transaction experience, with particular expertise in workout, bankruptcy, and other special situations.

EDUCATION, LICENSES, & CERTIFICATES

- MBA, Miami University
- BS, Business Administration/Marketing, Miami University
- Illinois Real Estate Managing Broker
- Illinois Auctioneer
- Illinois Notary
- Wisconsin Auctioneer
- Texas Auctioneer
- Certificate Commercial Investment Member (CCIM) Designee
- Certified Auctioneers Institute (CAI)
- Accredited Auctioneer of Real Estate (AARE)

REPRESENTATIVE CLIENTS

FINANCIAL & PRIVATE EQUITY

- Bank of America
- Chase Bank
- BB&T Bank
- Hanmi Bank
- National Credit Union Association

CLIENTS CATEGORIES

- Bankruptcy and Real Estate Attorneys
- Trustees
- Receivers
- Turnaround Consultants
- US Marshals Service

PROFESSIONAL AND INDUSTRY EXPERIENCE:

- David has more than 13 year's experience in real estate advisory and transaction experience, with particular expertise in workout, bankruptcy, and other special situations. David began his career in general management and marketing roles for various consumer product companies., and most recently as the Vice President of NRC Realty & Capital Advisors.
- David holds both the Certified Commercial Investment Member (CCIM) and Certified Auctioneers Institute (CAI) designations, making one of fewer than fifty professionals in the United States to hold both. He is a frequent speaker and moderator on real estate restructuring programs, a member of the Turnaround Management Association Chicago/Midwest Board of Directors, and has held various leadership roles on the American Bankruptcy Institute Real Estate Committee.