Economic Update

FEBRUARY 19, 2021

1. INDUSTRIAL SECTOR

- According to Real Capital Analytics, hedonic cap rates for Industrial properties held at their all-time low through Q4 2020, finishing the year at an even 6.0%. Between strengthening property fundamentals and lower benchmark interest rates, oppositional pressures have led to cap rate stability for CRE's best performing sector in 2020. According to RCA, hedonic cap rates have now sat at 6.0% for five consecutive quarters.
- Price growth remained healthy for industrial assets in 2020, though the rate of appreciation slowed from the year prior. According to RCA, pricing for industrial assets averaged $123/SQFT through Q4 2020, up 5.4% over the $117/SQFT measured in Q4 2019. The growth rate stood nearly twice as high in 2019, with assets then appreciating by 10.1%.
- The industrial sector's quarterly transaction volume continued its speedy path back to normalcy in Q4, with RCA tracking more than $36B in trades– down just 2.1% from Q4 2019. The Q4 reading improved quarter-over-quarter by 116% and stands 190% above its Q2 2020 lows.

2. RETAIL SECTOR

- According to Real Capital Analytics' hedonic series, retail cap rates ticked down by 6 bps to close out 2020, finishing the year at 5.6%. Cap rates finished 2020 down by 20 bps from where they stood in Q4 2019.
- Despite consecutive quarters of improvement, voluntary retail trades have yet to return to healthy levels. RCA tracked $11.9B in transaction volume for the sector in Q4 2020, a 64% improvement from Q3, but still a 42% drop off from the same period the year prior.
- For the retail sector as a whole, asset prices fell by an average of 6.7% between Q4 2019 and Q4 2020. Asset devaluation was common across the sector, but retail centers saw the worst of the downside pressures, with the subsector posting an average price drop of 13.2%. Unanchored, Anchored, and Single-Tenant retail assets also saw especially deep dips in pricing, with all three subtypes declining by more than 7% year-over-year. As one might expect during a year dominated by a global pandemic, drug store assets posted the most property price appreciation of any retail subtype in 2020, with average valuations growing by 4.1%.

3. SINGLE-FAMILY RENTALS

- Rent growth in single-family rental (SFR) properties strengthened in November, up by 3.7% year-over-year, according to the Core-Logic Single-Family Rent Index (SFRI). During 2020, annual rent growth tapered off, falling as low as 1.4% in June, but has steadily recovered in the months since.
- Within the SFR sector, lower-priced rentals enjoyed more price growth than the higher-tier from 2014 until late-2020. In November 2020, the trend reversed. Rent growth for lower-tier units remains below their pre-

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33 Arch Street, 17th Floor
Boston, MA 02110
T: 888-311-0605

pandemic level, a consequence of COVID's asymmetric impact on lower-wage workers.
- Looking city by city, Phoenix charted the largest year-over-year increase by any Top-20 metro area at 9.9%. The Valley of The Sun has dominated all other US metros in this category since late-2018.
- Boston's SFR market posted the worst year-over-year decline, with rents falling by 4.6%.

4. WORK FROM HOME

- According to a recent PwC Survey, US Executives are in increasing agreement that a forced transition to work from home (WFH) business models have proven successful. When polled in June 2020, 73% of employers reported that the transition was successful. When executives were asked the same question again near the end of the year, the share jumped to 83%.
- Just one-in-five (21%) executives think that having their team members in the office five days a week is optimal for maintaining a strong corporate culture. The modal response was three days a week, which 29% of executives believe to be the goldilocks-zone.
- The growing acceptance of WFH and the likelihood of its continued adoption in a post-COVID world is made evident by the types of investments executives are making in their workforce infrastructure. 72% of those surveyed report plans to increase their spending on virtual collaboration tools, while 70% and 64% report plans to increase spending on IT/secure virtual connectivity and digital workforce training, respectively.

5. LABOR MARKET

- The civilian unemployment rate (U3) resumed its downward trend in January, falling to 6.3% from 6.7% the month prior. Between February and April, U3 surged from 3.5% to 14.8%.
- While a falling unemployment rate sounds like a positive development on the surface, it is not necessarily the case. The unemployment rate falls either when unemployed workers find jobs (positive) or when unemployed workers give up looking for jobs altogether and exit the labor force (negative). The labor force participation rate fell again in January, declining from 61.5% to 61.4%—a sign that U3's most recent progress is at least partly a false-positive. Moreover, after improving between April and August, the labor force participation rate has fallen in three of the past five jobs reports.

6. JOB-OPENINGS AND LABOR TURNOVER SURVEY

- Roughly 6.6 million Job Openings were available in December, barely budging from the previous month, according to the BLS's Job Openings and Labor Turnover Survey. New hires dropped by a discouraging 400k in December, the fourth largest dip in the past year.
- Over the year 2020, the industries that saw the largest increase in job openings were professional and

business services, non-durable goods manufacturing and transportation, warehousing, and utilities. The largest decrease in job openings occurred in state and local government occupations.
- According to the NFIB's Small Business Economic Trends Survey, 33% of small business owners reported having positions open that they have been unable to fill in January, down from 37% from one year ago, but well above the May 2020 low of 23%. Moreover, 21% of small business owners see labor quality as their top operating concern, topping all other responses.

7. FROM THE FED

- In its January policy meeting, the FOMC held its target federal funds rate range between 0% and 0.25%, committing to this ultra-low window until labor market conditions improve and inflation rises to its 2% target. The committee maintains that it will allow inflation to run moderately above 2% for some time – a tolerance that aligns with the Central Bank's goal for inflation and inflation expectations to anchor near 2% over the long-run.
- The current Fed-funds rate target was reintroduced in 2020 in response to the COVID-19 pandemic to promote its dual mandate (price stability and full-employment). In its most recent meeting, the committee cited the recent slowdown in the US economic recovery as a primary concern, noting the dependence on the course of the virus, including vaccination progress.
- In a February 10th speech, Fed Chair Jerome Powell attempted to moderate concerns about inflation risks, citing that "inflation has been much lower and more stable over the past three decades than in earlier times." Recently, several prominent economists, most notably Larry Summers, have raised concerns that too much fiscal support could lead to a surge in inflation.

8. INFLATION

- As measured by the Consumer Price Index (CPI), prices of goods and services are up 1.4% in January from one year ago. January's measure is a repeat of the previous month. Core-CPI, a measurement of inflation that excludes food and energy, was also unchanged in January.
- After eclipsing 2.0% for several separate periods between 2016 to 2019, CPI fell dramatically throughout 2020 as COVID-19's impact reduced consumption, placing downward pressure on consumer prices. Price growth fell precipitously through the crisis, entering 2020 at a healthy 2.5% and quickly falling as low as 0.2% in May.
- A slight positive level of inflation helps the Federal Reserve accomplish a number of its pro-growth goals, with none more sacrosanct than its role in guarding against deflation. The Federal Reserve recently amended its long-run objectives, stating that they would now be willing to tolerate inflation above their stated 2% target for an extended period.

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9. APARTMENT RENTER PERFORMANCE

- The NMHC's Rent Payment Tracker reported that 79.2% of renter households made rent payments by February 6th, up by 1.9% from the same day last month.
- According to the Census Bureau's Household Pulse Survey (HPS), for the two-week period ending on February 1st, 68.8% of renters expressed moderate or high confidence in their ability to pay the next month's rent. This is up slightly from 65.1% from the same period in the previous month.
- The slight rise in tenant sentiment and performance comes amid falling COVID-19 cases and broad expectation of additional economic stimulus on the horizon.

10. FREDDIE MAC MORTGAGE RATES

- According to an analysis of the Freddie Mac Primary Mortgage Survey, mortgage rates have held relatively flat over the past several weeks. The yield on the 30-Yr fixed-rate mortgage has averaged 2.73% since the start of 2021. In 2020, rates averaged 3.11%, an all-time low.
- Rates on the 15-year fixed-rate mortgage have averaged 2.20% since the start of 2021, down 40 bps from its 2020 average of 2.60%.
- Mortgage rates across the board tumbled in Q1 2020 as a global 'flight to safety' suppressed long-dated government bond yields, and the Federal Reserve took a more accommodative monetary policy stance. Recently, falling cases and improving macroeconomic fundamentals have led to a rise in Treasury rates, but mortgage rates remain steady at historical lows.

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SUMMARY OF SOURCES

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