Altus Group

Q4 2023

Commercial Real Estate Industry Conditions & Sentiment Survey

US survey results

Introduction

Altus Group is pleased to share the results of our Commercial Real Estate Industry Conditions & Sentiment Survey with survey participants and partners. This survey was conducted by Altus Group's Research Team across the United States in an effort to provide insights into the market sentiment, conditions, metrics, and issues affecting the commercial real estate (CRE) industry.

The survey captures the individual practitioner's perspective, representing various functions and across the capital stack. Participation in the survey is voluntary and responses will remain confidential.

As always, we invite you to share any feedback or questions with your Altus Group contact or reach out to the Altus Research Team directly at altusresearch@altusgroup.com.

Survey size & methodology

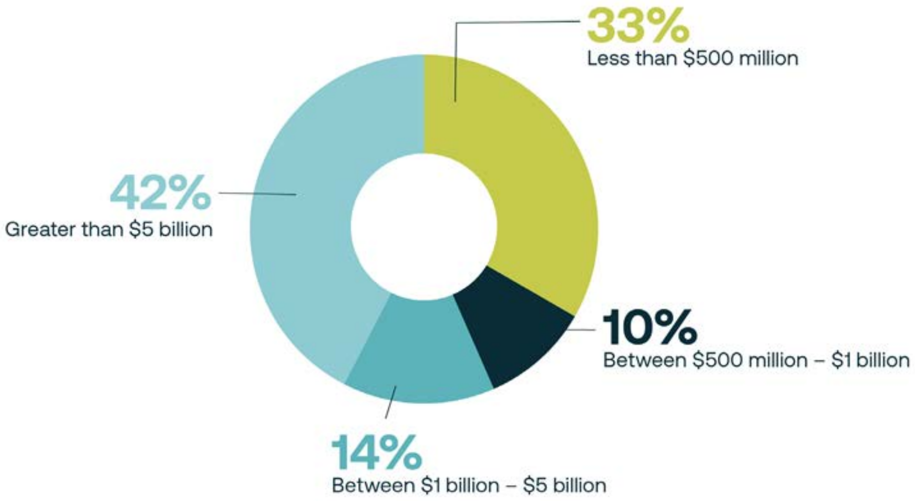
Altus Group's Research Team surveyed industry participants across the US from October 13 to November 1, 2023. There were 197 respondents, representing at least 51 different firms[1].

Questions in the survey were optional and explored two main topics: current conditions and future expectations. Percentages represent the share of all responses received for each question, excluding “blank” or “not applicable” responses.

197 responses

from more than **51 different firms**

Firm CRE exposure



Notes: 1) Firm count based on participants who chose to identify themselves.

Organization type

Service provider	27%
Investment manager	16%
Private equity or REIT	13%
Developer	12%
Asset management company	7%
Bank	6%
LifeCo or Insurance Company	5%
Family office or sovereign wealth fund	3%
Other	9%

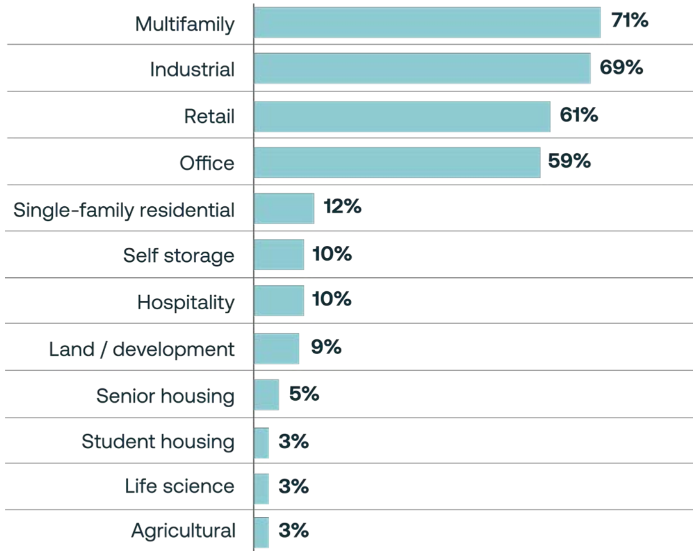
Functional area

Appraisals / valuation	32%
Investments / fund / portfolio management	27%
Asset or property management	12%
Capital markets / financing / lending	11%
Brokerage (investment sales or leasing)	10%
Research / economic consulting	2%
Other	5%

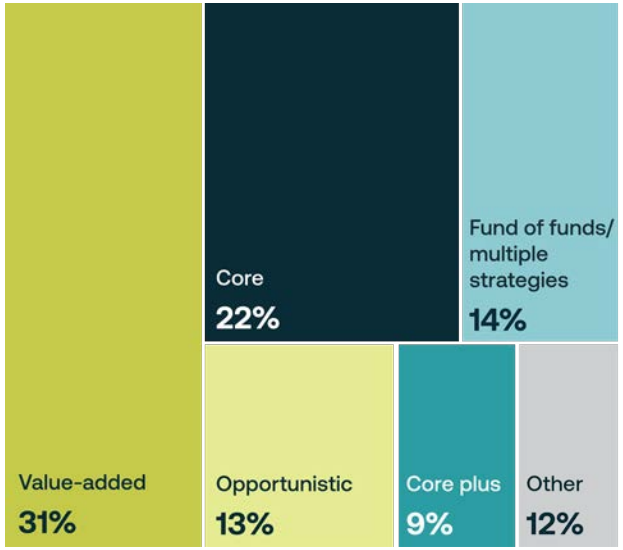
Percentages are rounded, so they may not sum up to 100%.

Respondent characteristics

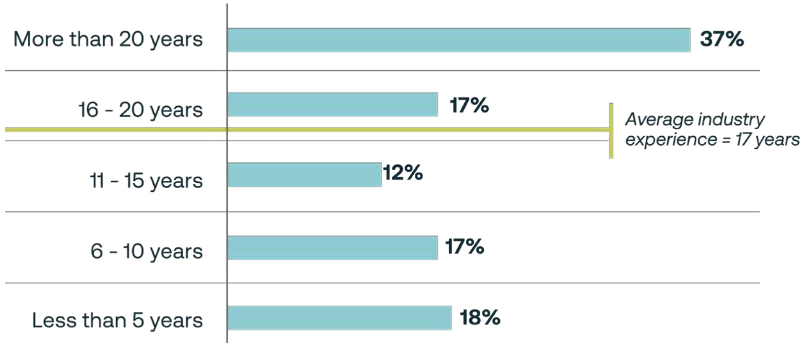
What property types does your firm primarily focus on?



How would you describe your firm's primary investment strategy?



How many years of experience do you have in the industry?



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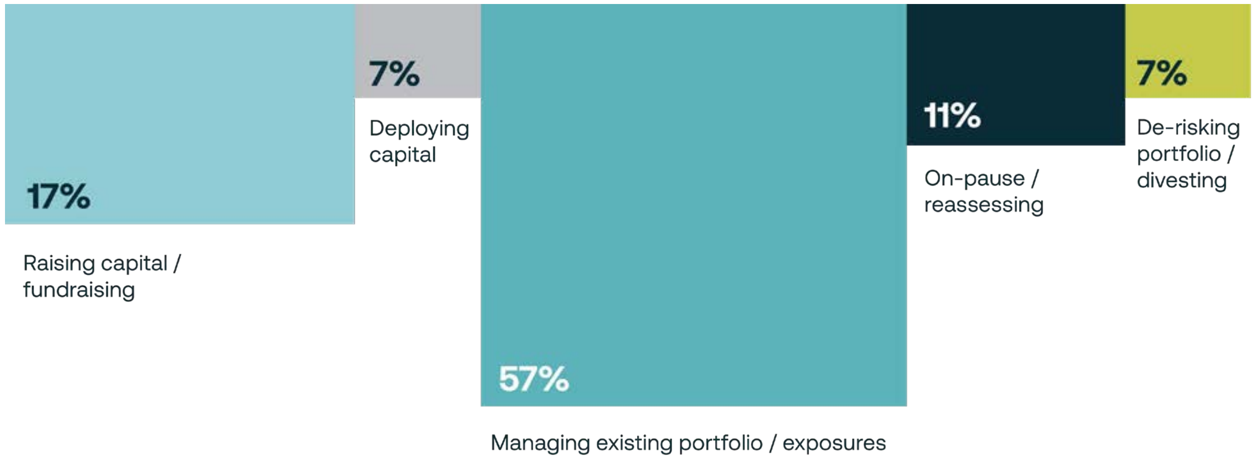
Current focus

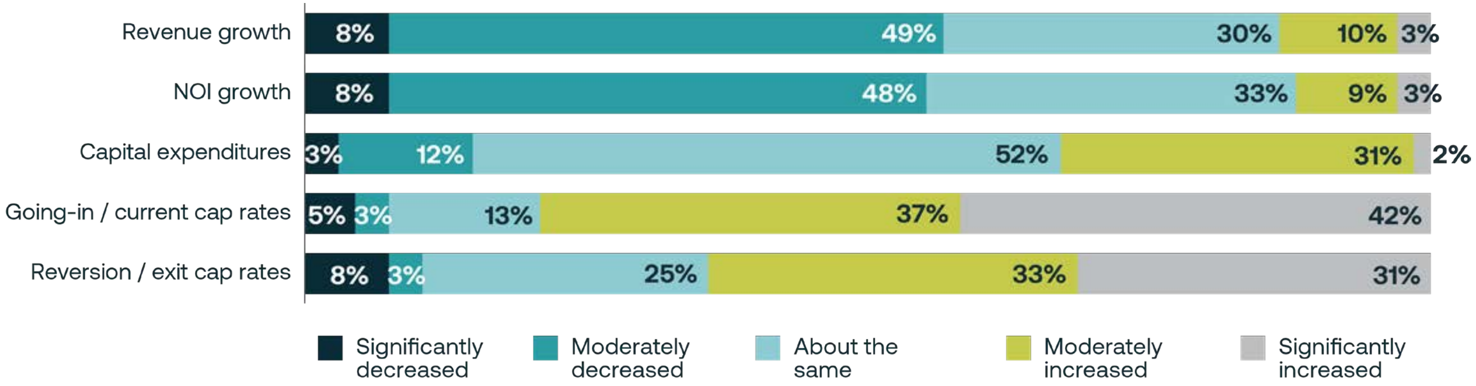
What do you think your team's primary focus will be over the next 6 months?

Capital raising slows, de-risking picks up. The share of respondents focused on managing their existing portfolios grew from 48% in Q3 2023 to 57% in Q4 2023. Nearly a quarter (24%) of respondents said they are raising or deploying capital, down from 39% in the prior quarter. The share of respondents either on-pause or actively de-risking their portfolio increased to 18%, up from 13% in the prior quarter.



How have your expectations for your portfolio changed compared to 12 months ago?

Fundamental expectations continue to deteriorate modestly. The CRE industry's expectations have moderately deteriorated over the previous 12 months. More than half of respondents noted their expectations for revenue and NOI growth have declined compared to 12 months ago – in line with the prior quarter's survey results. While there was little change in expectations for capital expenditures, nearly 80% of respondents noted moderate to significant shifts in their expectations for going-in and current cap rates, while more than 60% noted a similar shift in their expectations for reversion and exit cap rates.



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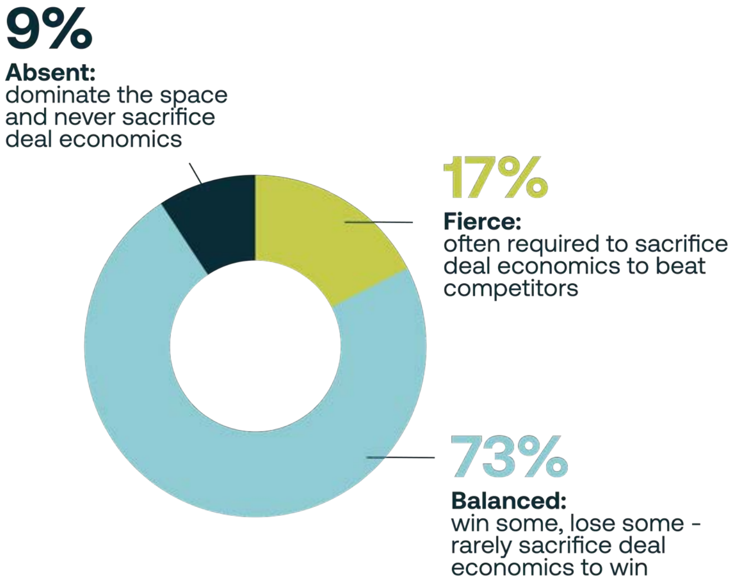
Competition and pricing

How would you describe the level of competition among your firm's peer group?

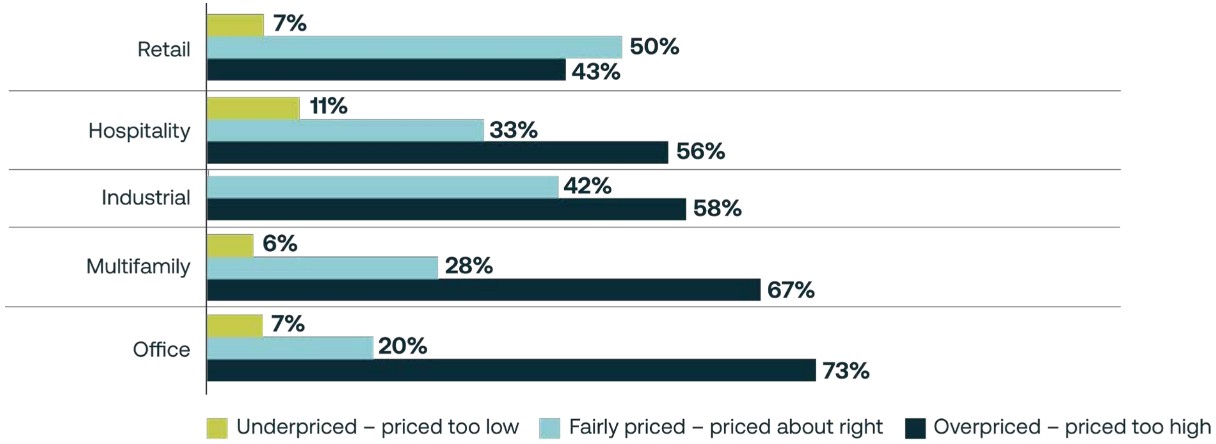
Competition declined slightly from the prior quarter. While the majority (73%) of respondents described the current level of competition as “balanced: win some, lose some”, approximately 9% of respondents described the current level of competition as “absent: dominate the space and never sacrifice deal economics”, up from 4% in the prior quarter. The remaining 17% described the current level of market competition as “fierce: often required to sacrifice deal economics to beat competitors”. Altogether, the responses suggest that despite the sharp decline in transaction volume seen in 2023, the market remains competitive.



Note: Percentages represent the share of all responses, excluding “blank” or “not applicable” responses.

How would you characterize current pricing for the following property types?

The majority of respondents characterized the current CRE market as being overpriced, a significant shift from the prior quarter’s survey. A majority of respondents (>50%) indicated that many of the largest property sectors (office, multifamily, industrial, hospitality) are overpriced, with office and multifamily being the most pronounced.



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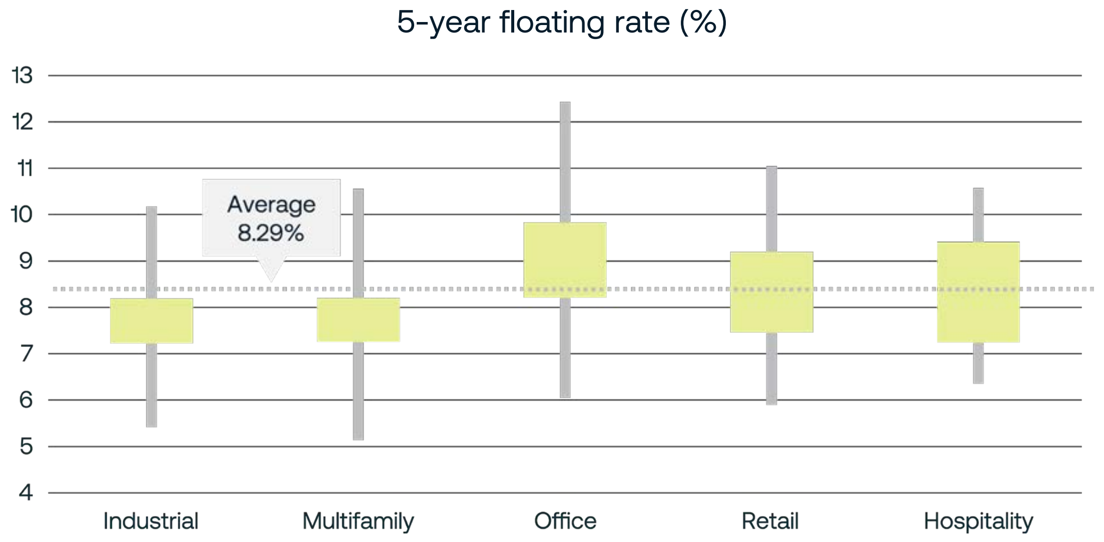
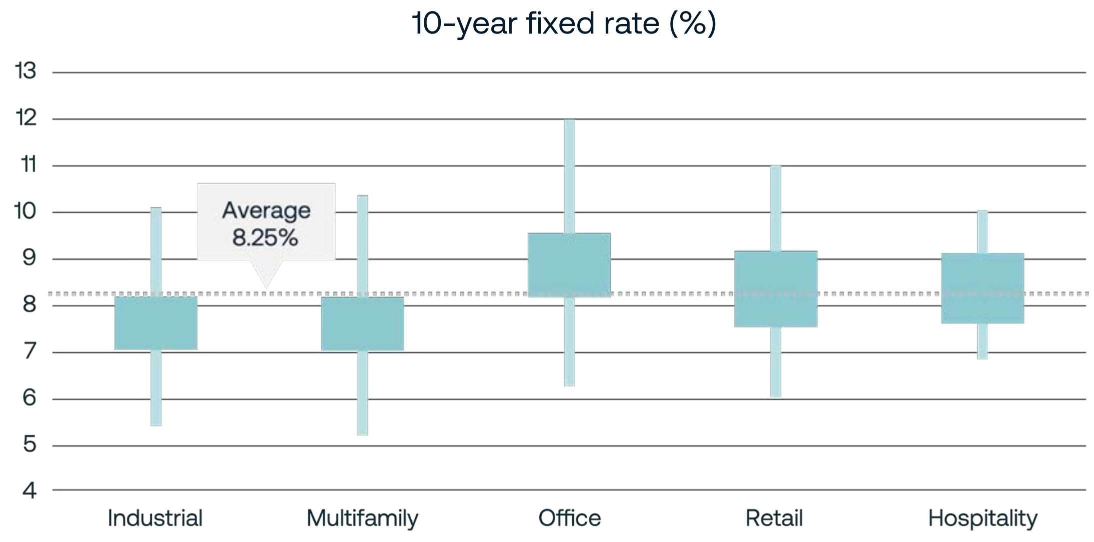
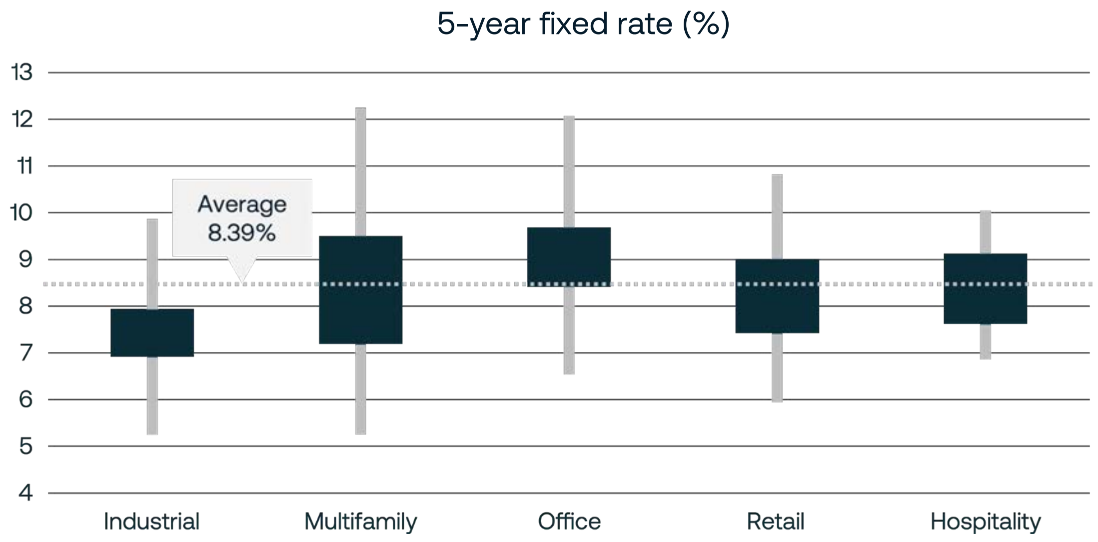
What all-in interest rates are you seeing in the market?

Elevated cost of capital across property sectors. Responses reflected the elevated capital costs across property types. The overall average 10-year fixed-rate financing across the main property sectors was 8.25%. There was notably little difference in the overall averages between 10-year fixed-rate and shorter-term financing options (5-year fixed and floating rate). Responses varied widely for many property types but generally showed that industrial and multifamily continue to be favorites, while retail and hospitality fall somewhere near the middle, and office is the least favored – reflected in the highest cost of debt financing. This was a new question to the survey, so comparisons to the prior quarter were not possible.



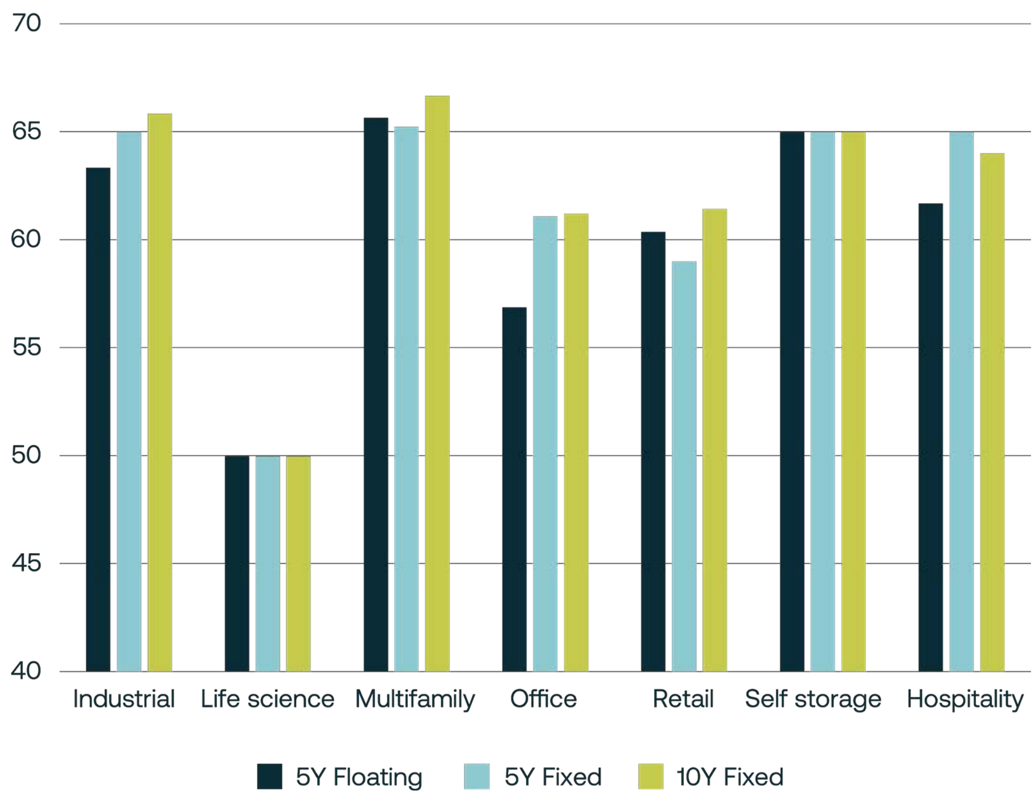




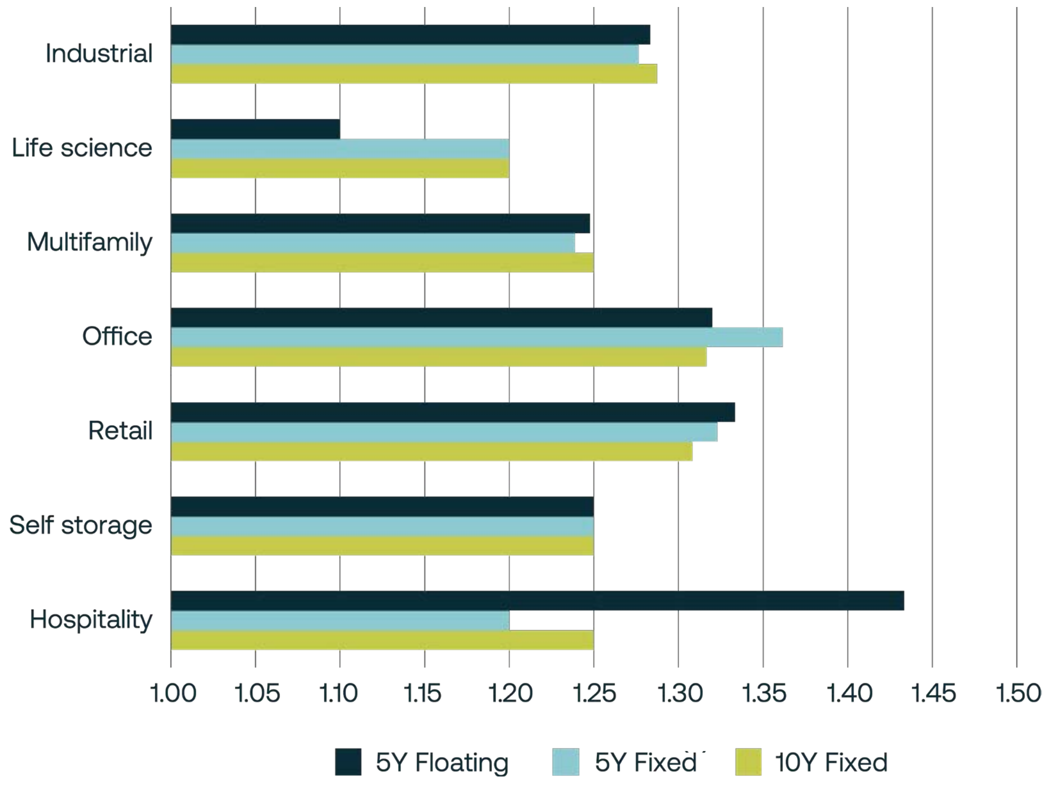
What senior debt financing terms are you seeing in the market?

Conservative underwriting persists. Current underwritten debt financing terms reflect a level of conservatism that persists across lenders, similar to the trend reported by the Federal Reserve Senior Loan Officer Survey. While respondents noted a generally "overpriced" market, loan-to-value (LTV) ratios remain below 70% and debt service coverage ratios (DSCR) remain above 1.2x for nearly all property types.

Maximum LTV (%)



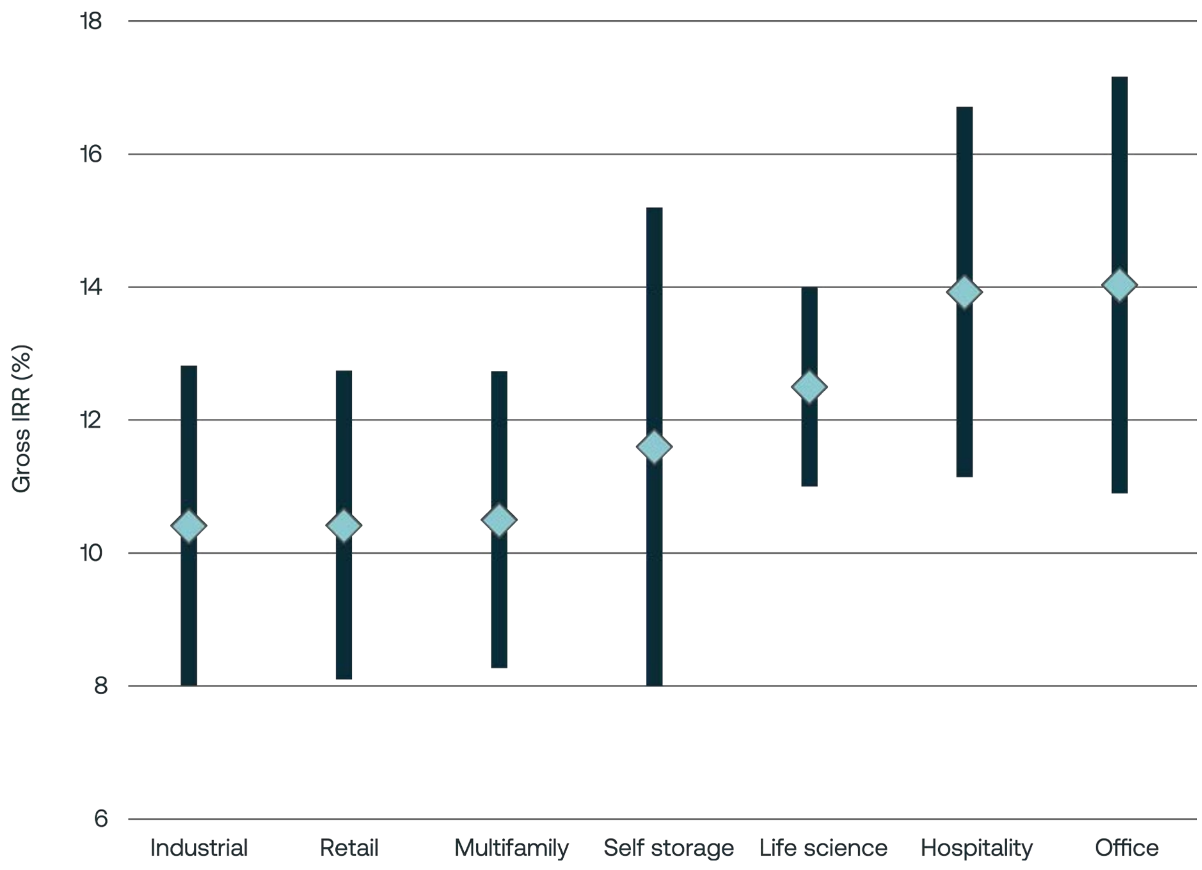
Minimum DSCR (x)



Reported current market gross IRRs

Return profiles by property type show a new "core" emerging. Reported gross IRRs seen marketed for new funds and deals averaged 11.9% across property types. While the reported gross IRR returns ranged widely by property type, the main property types (industrial, retail, multi-family) showed very similar ranges (low of 8.0% and high of 12.8%, midpoints of 10.4% to 10.5%). Responses varied most for self-storage, which had a midpoint of 11.6%, but a low of 8.0% and a high of 15.2%. Reported marketed office returns topped the IRR ranking, with a midpoint of 14.0% and the second widest range of responses (low of 10.9% and high of 17.2%) – likely reflecting more opportunistic-style office deals being marketed.

What are typical ranges for the gross IRRs seen across the current market for new funds?



Recession expectations

Consensus emerges, a shallow recession is expected within the next 6 months. A significant majority of respondents (77%) indicated that a recession is expected in the next 6 months, with 22% expecting a recession to be "very likely" and 55% expecting a recession to be "somewhat likely". Recession expectations were relatively consistent across different risk profiles and strategies, but were most pronounced among core and opportunistic strategies. More than a quarter (27%) of respondents who identified as having a core strategy indicated that a near-term recession was "very likely", while more than two-thirds (64%) of respondents who identified as having an opportunistic strategy said a near-term recession was "somewhat likely". The shape of the next recession is expected to be shallow. While a majority (80%) of respondents expected the next recession to be shallow, the expected duration of the next recession was largely split, with 37% of participants expecting the next shallow recession to be short-lived and 43% expecting it to be long-lived. Expectations for severity (shallow or severe) and duration (short-lived or long-lived) varied most notably amongst the responses from the opportunistic and value-added strategies, which had the largest cohorts of "Shallow and short-lived" and "Severe" responses, respectively.

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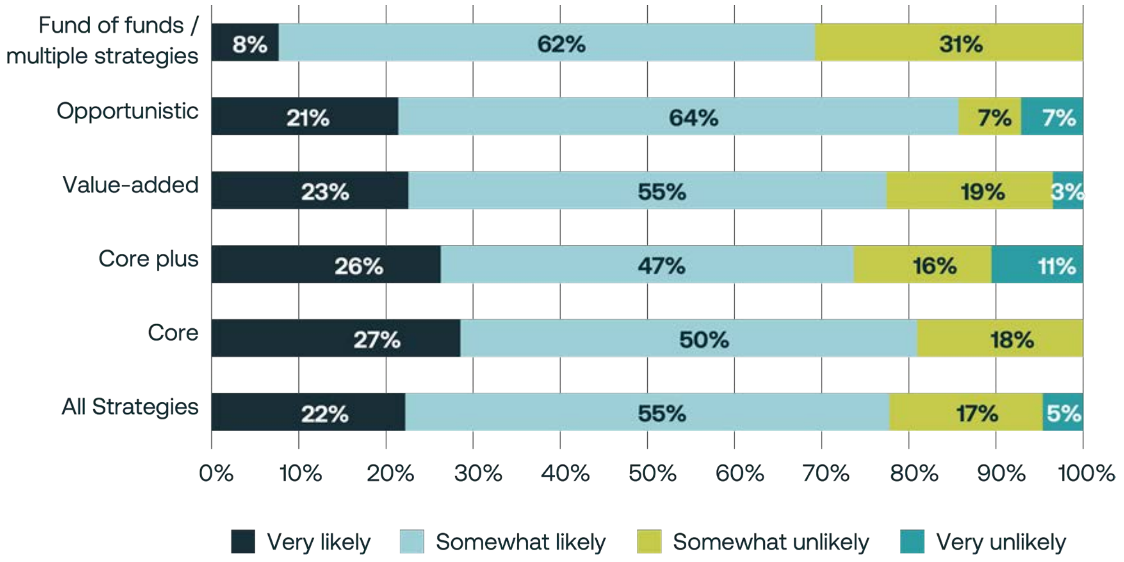
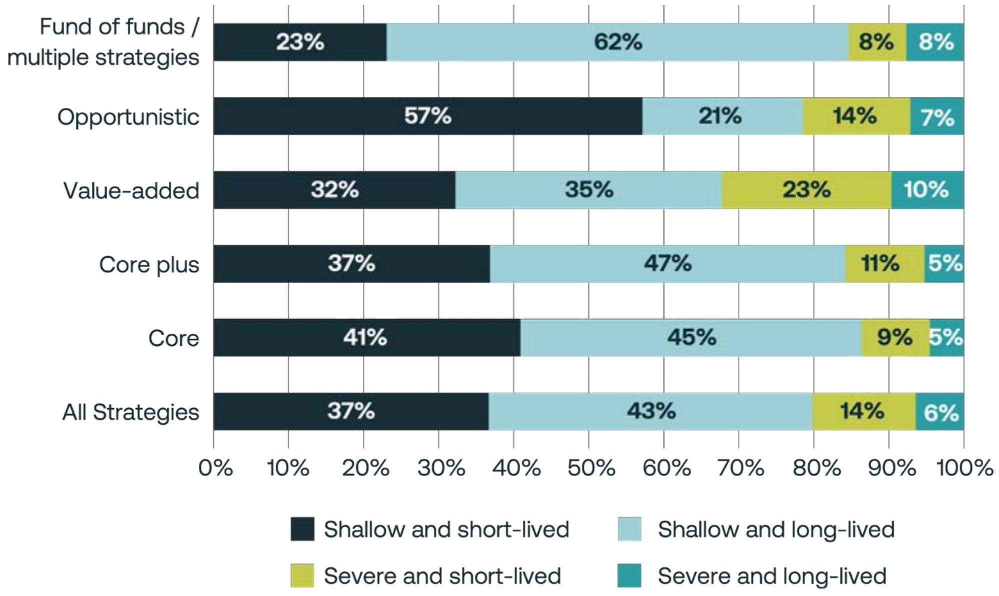
How likely is an economic recession within the next six months?



What will be the depth and length of the next economic recession?



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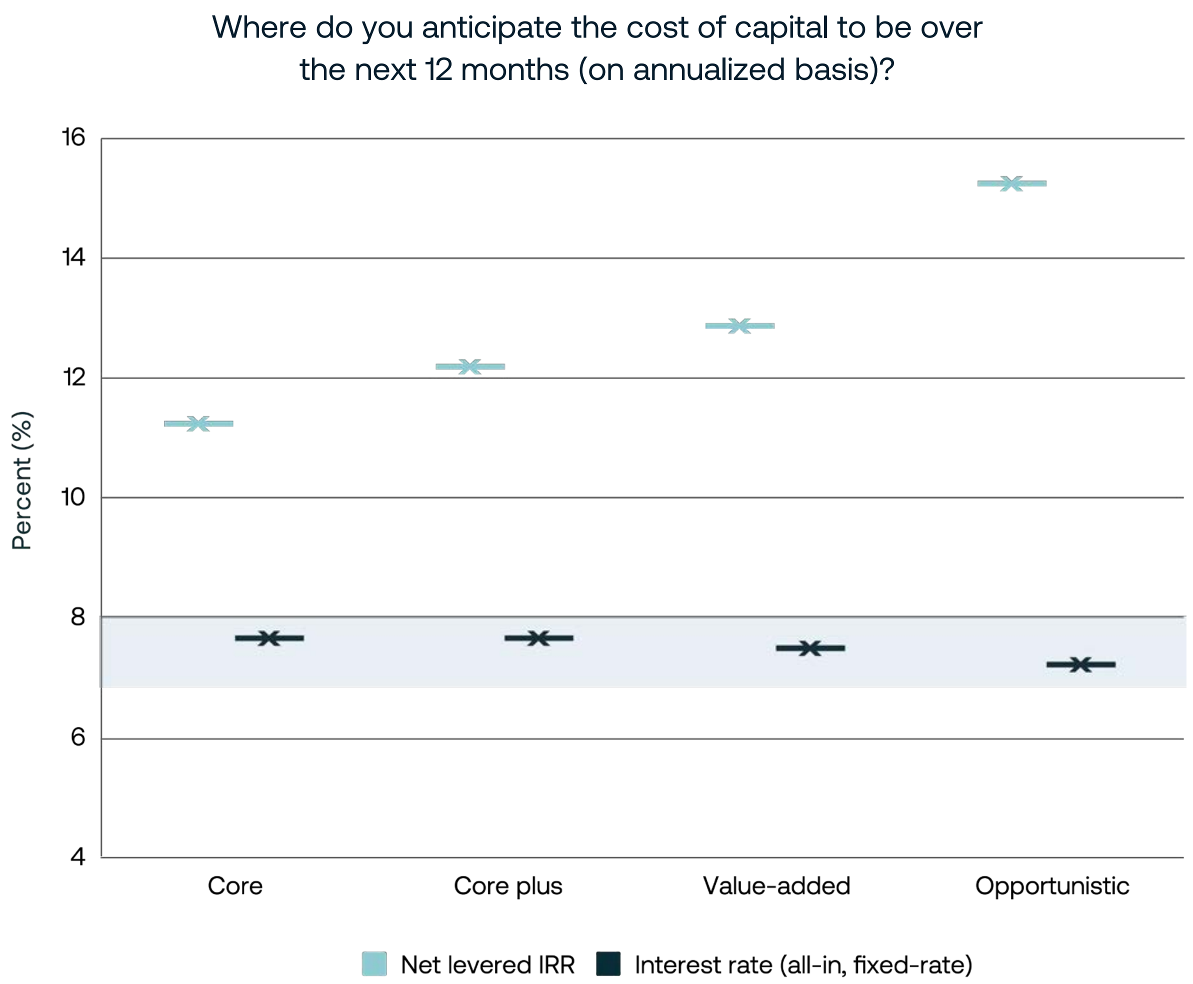
Cost of capital expectations

Forward view on interest rates stabilizes, and return targets by strategy emerge. Respondents' 12-month forward view of all-in, fixed-rate financing was range-bound between 7.2-7.7%, across the main portfolio strategies. This suggests that there may be a consensus view on where borrowing costs will settle. Net levered IRRs reported across the strategies differed, reflecting the different risk profiles targeted. Net levered IRRs ranged from 11.2% for core strategies to 15.3% for opportunistic strategies.



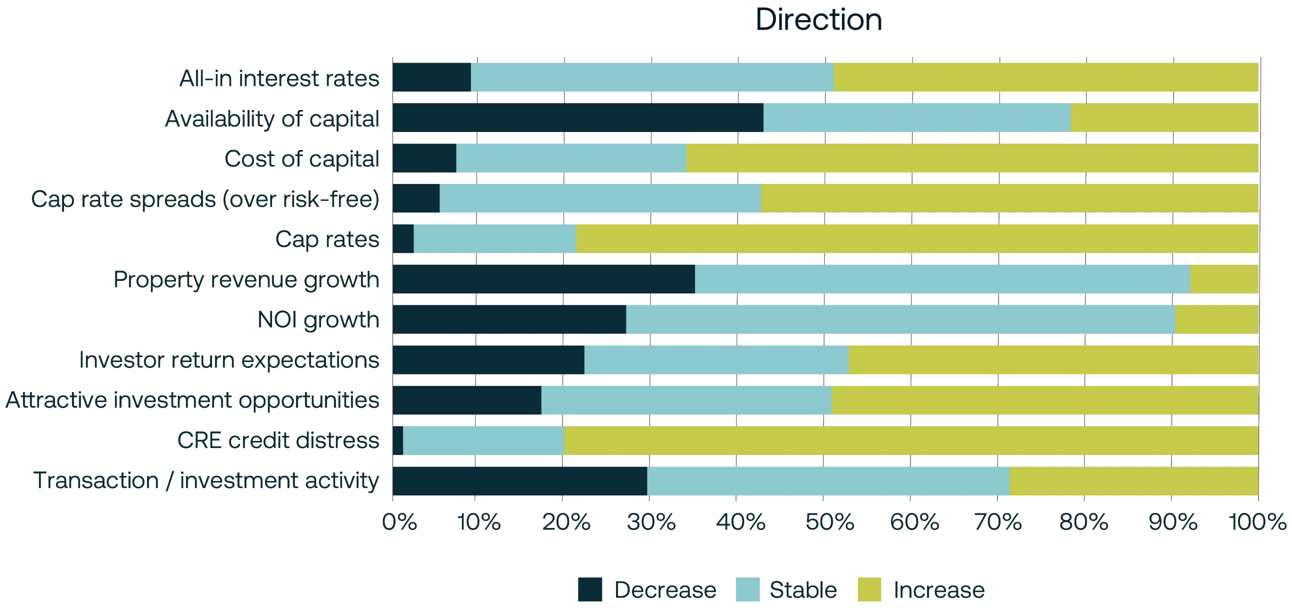
What changes do you anticipate to the following key metrics over the next 12 months?

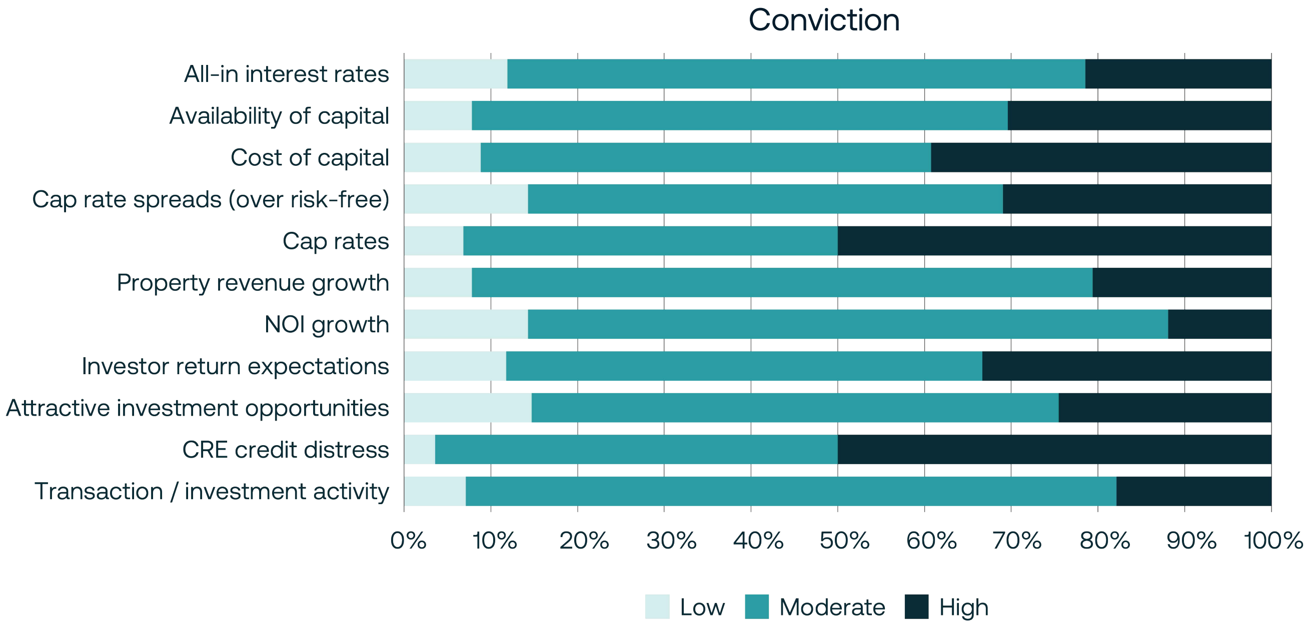
CRE capital conundrum continues. Respondents indicated that aggregate interest rates are expected to rise and capital will become less available – the conviction remained weak-to moderate, suggesting collective uncertainty. Illustrating the point, more than two-thirds of participants expect cost of capital increases, but only 40% noted high conviction in their call. There was little change from the prior quarter.

Cap rate increases expected, pointing to a potential basis reset. Nearly 80% of respondents expect cap rates to increase over the next 12 months, with 50% of respondents noting high conviction. While there was less conviction in cap rate spreads over risk-free rates, more than 50% of responses pointed to spread widening.

Incrementally less cash flow uncertainty. Participants generally expect revenue growth to be stable (57%) over the next 12 months, though 35% expect declining revenue growth; these results were nearly unchanged from the prior quarter. Participants expect NOI growth to be stable (63%) or decrease (27%) – an improvement from one quarter ago, when 57% reported "stable" and 32% reported "decrease". Revenue and NOI growth expectations taken together could suggest that owners feel as though they have better control of expenses.

Increased distress, mixed transaction activity. 80% of respondents expect CRE distress to increase over the next 12 months, the highest conviction response (75%). This distress opportunity likely contributes to the expected increase in attractive investment opportunities noted by 49% of respondents. But overall transaction activity is still viewed as a bit more mixed – responses were evenly distributed.





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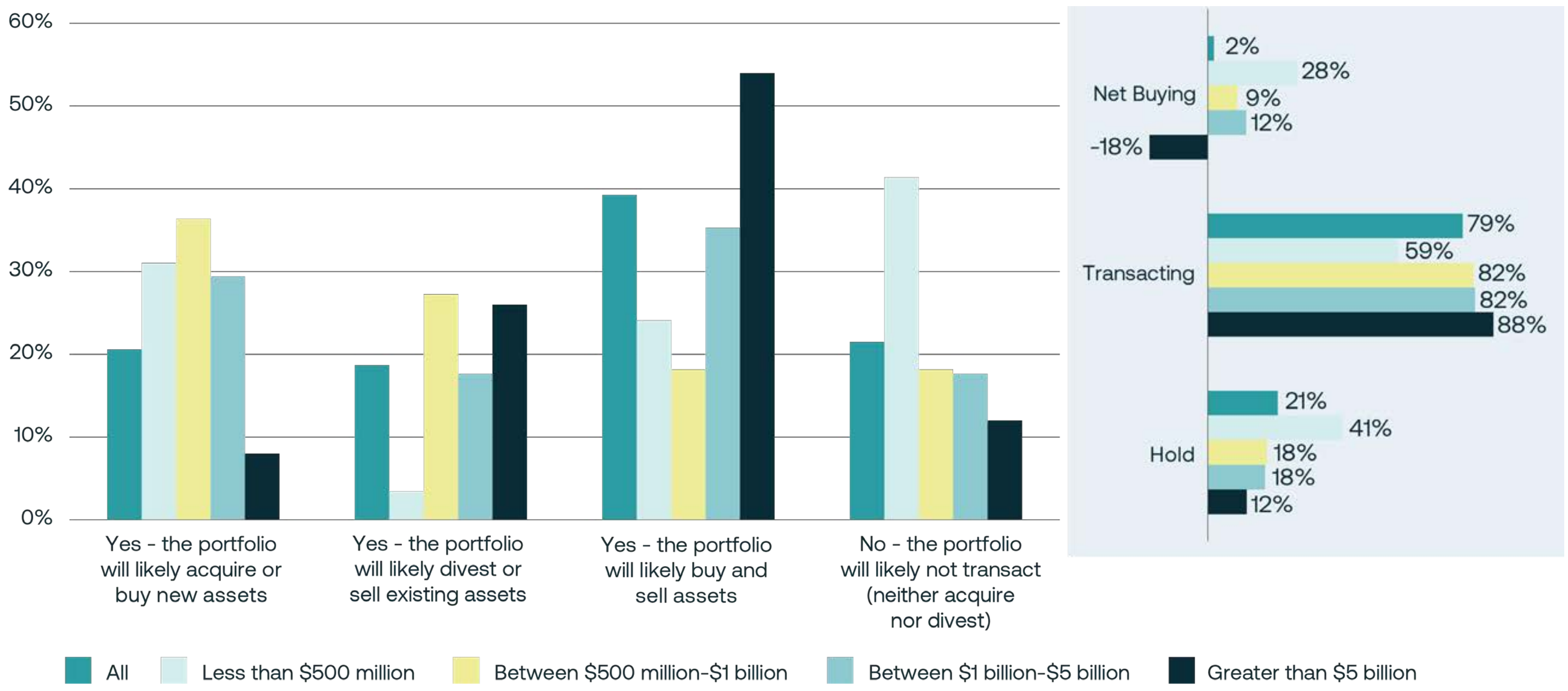
Transaction intentions over next 6 months

Near-term transaction activity to pick up; big selling to small. After a prolonged period of muted transaction activity, respondents indicated that the market activity is likely to pick up over the coming 6 months. The majority (79%) of survey participants noted plans of transacting over the next 6 months, though these intentions vary significantly by firm size. Larger institutions (>$5 billion) plan to be net sellers, while smaller firms (<$5 billion) plan to be net buyers.

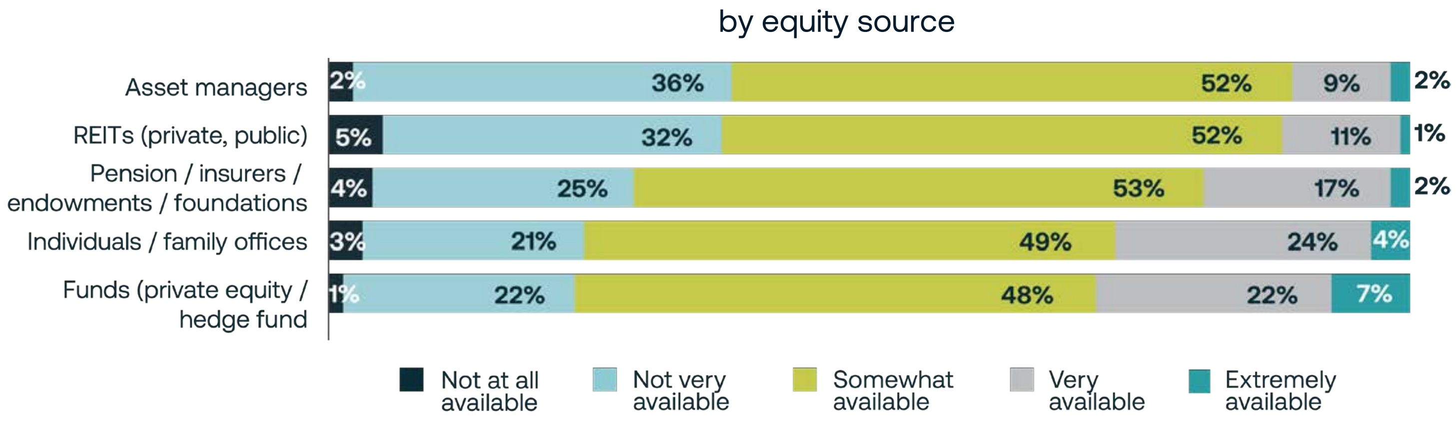
Over the next 6 months, do you anticipate any transactions in your portfolio?

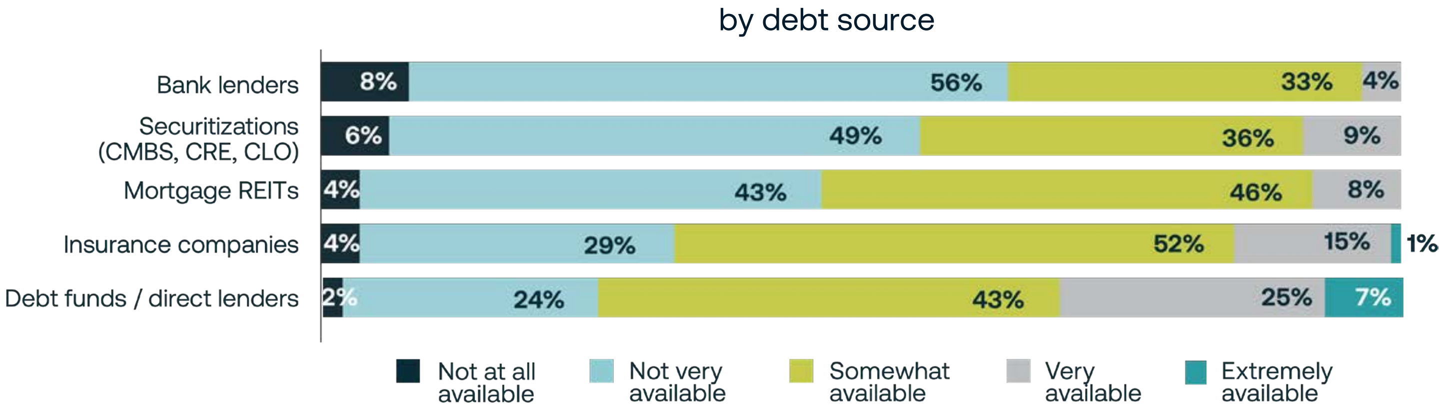


Capital availability

Capital is still available, but hard to come by. While there was a modest improvement in expectations for capital availability over the prior quarter, the current survey still reflects constrained expectations for capital availability from both equity and debt sources. Regarding sources of equity capital, responses indicate that the majority of equity will be “somewhat available” across different equity capital sources; responses ranged from 48% (Funds) to 52% (REITs). The equity capital sources expected to be least available were the asset managers and REITs, and the most available equity capital sources were the more nimble high-net worth individuals, family offices, and funds (private equity / hedge funds). On the debt side of the capital stack, responses indicated expectations for banks and securitizations to remain constrained, with a majority (>55%) of responses expecting these to be either “not at all available” or “not very available” over the next 12 months. Survey participants expect insurance companies (e.g., LifeCos) and debt funds / direct lenders to be much more active, with nearly 32% of respondents expecting capital from the latter to be either “very available” or “extremely available”.

What are your expectations for the availability of capital over the next 12 months?





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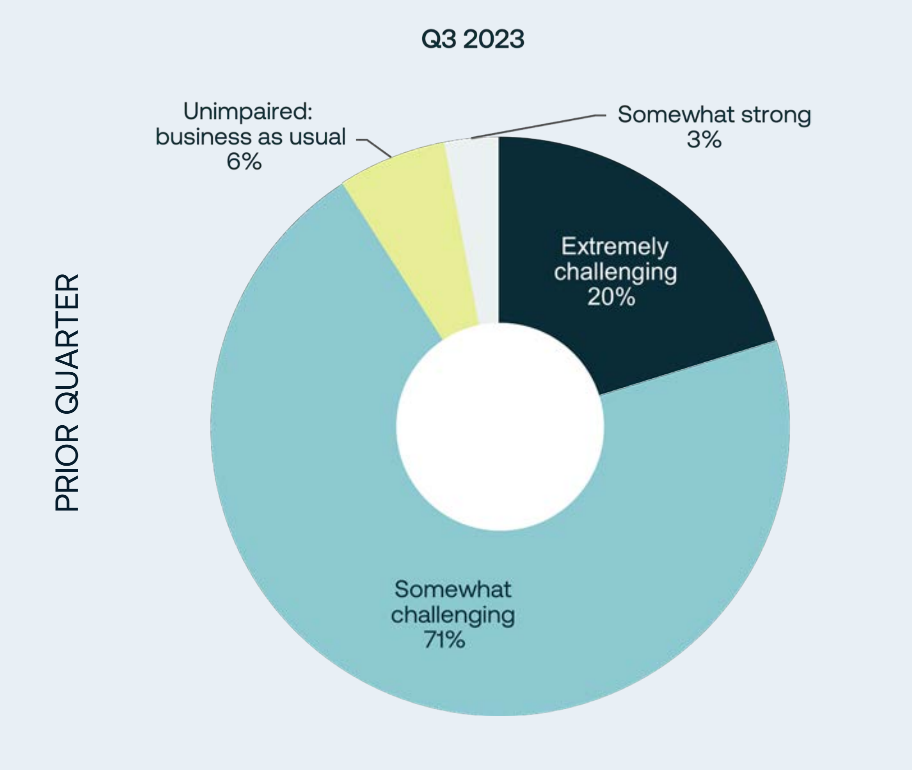
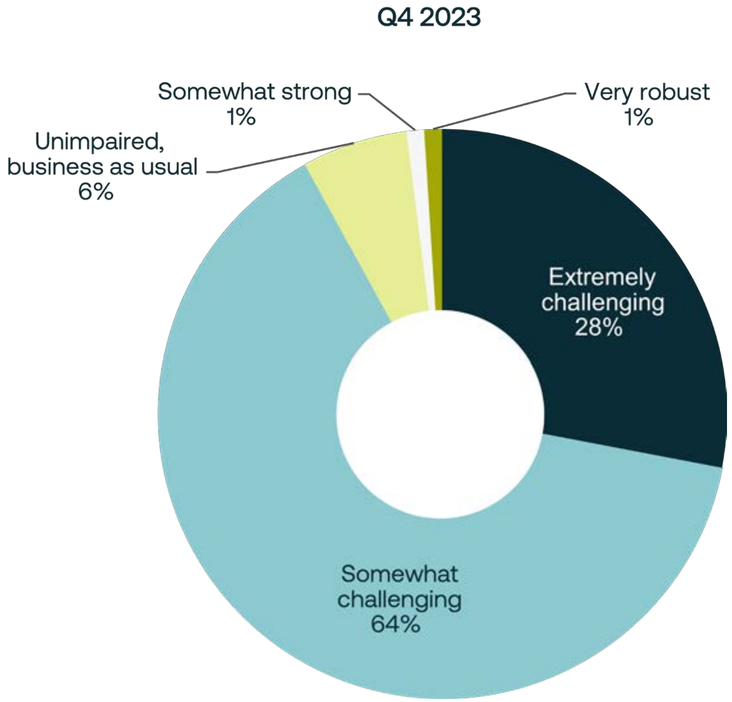
Expected operating environment

Increasing expectations for the challenging environment ahead. A total of 92% of respondents anticipate the coming months to be more difficult and pose some degree of challenge over the next 12 months. While the Q4 2023 responses indicated little change from the prior quarter, the percentage of respondents who expect the operating environment to be "extremely challenging" jumped to 28% up from 20% in the prior quarter.

What best describes your expectations for the operating environment over the next 12 months?



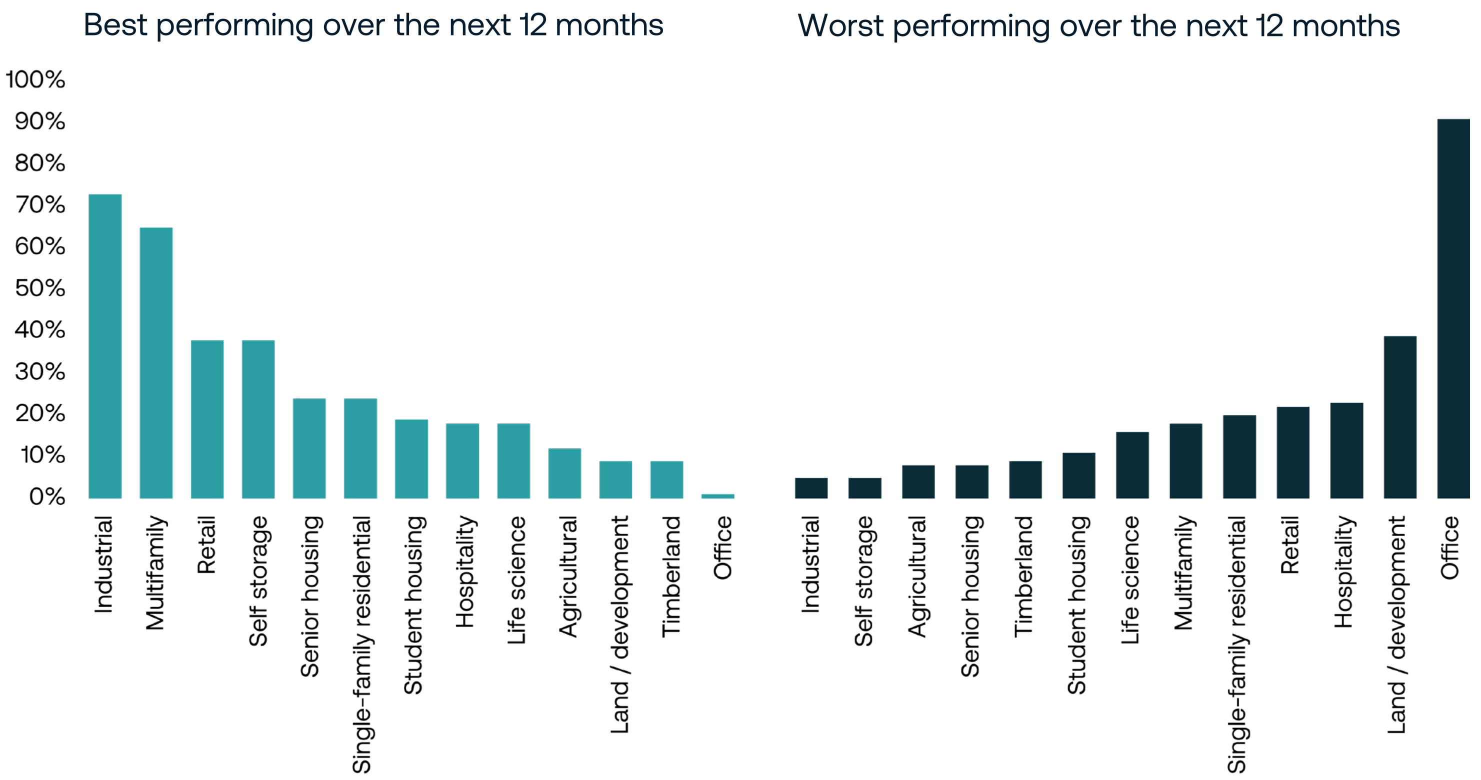


Note: Percentages represent the share of all responses, excluding "blank" or "not applicable" responses.

Expectations for property type performance

Little change to pecking order: multifamily and industrial favored over office; retail and single-family mixed. Survey responses suggest that participants still expect industrial and multi-family to be the best-performing property types and office to be the worst over the next 12 months. Expectations for retail remain mixed, but responses in the Q4 survey bumped it up one spot in the ranking to the third best-performing from the prior Q3 survey. Single-family residential fell three spots from the prior quarter to sixth-ranked best-performing and fifth worst-performing.

<u>How to read the charts:</u> The survey question asked participants to identify which property types they thought would be either "best" or "worst" performing in the next 12 months. Not all property types needed to be selected and any property type selected could only be identified as either "best" or "worst" performing, so no property could be identified as both "best" and "worst" performing. The percentages shown on the charts represent the portion of question respondents who included the property type as in either the "best" or "worst" performing categories.

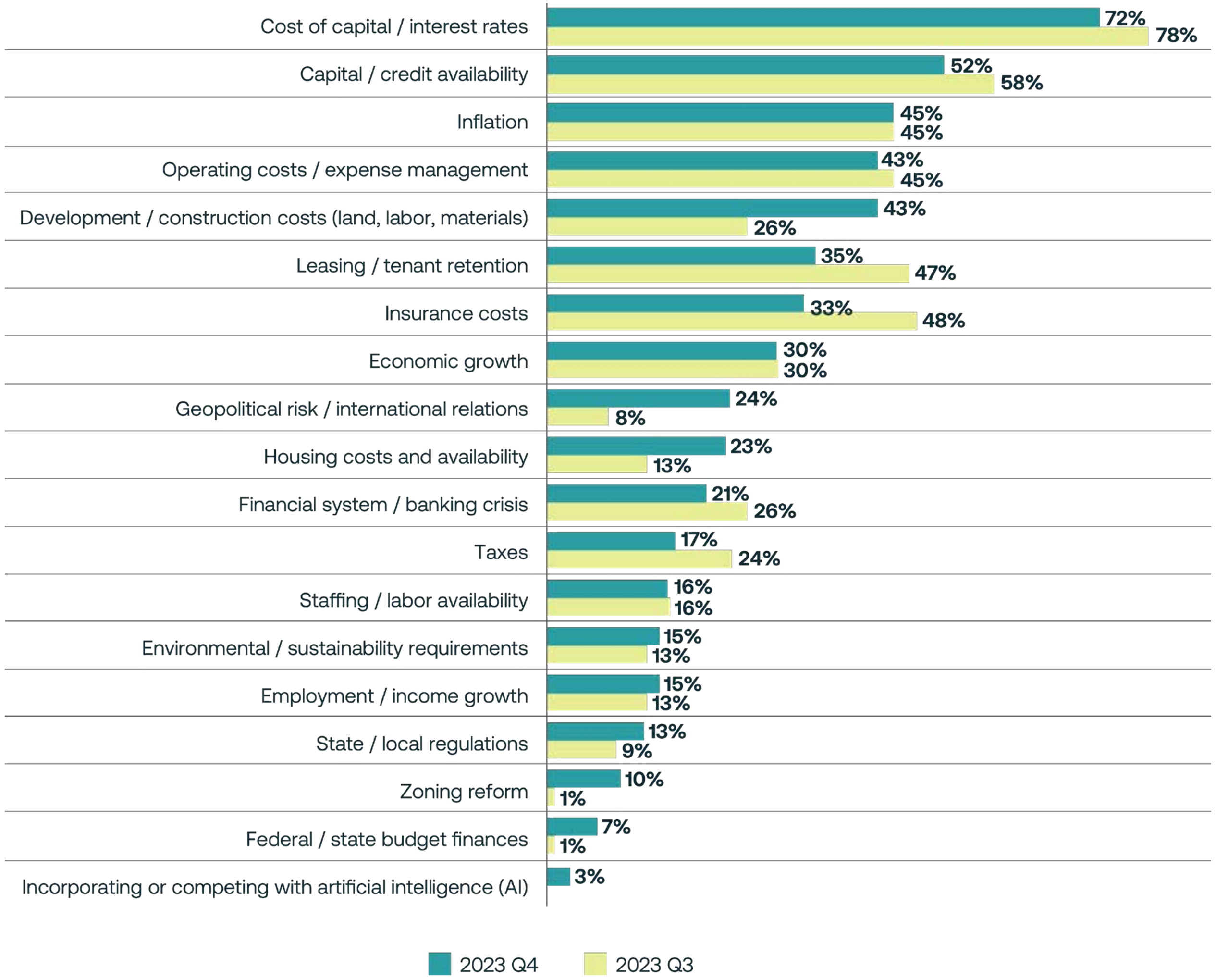


Note: Percentages represent the share of all responses, excluding "blank" or "not applicable" responses. Respondents could choose more than one property type to be either "best" or "worst" performing, so bars do not sum to 100%.

Priority issues over the next 12 months

Financing still tops priorities list, but moderates slightly. Cost of capital and credit availability topped the list of expected priorities over the next 12 months, and were followed by operating-related issues including inflation and expense management; more than 72% and 52% of respondents identified these issues as top-of-mind, respectively. Leasing / tenant retention and insurance costs continued to be high-priority issues, but saw notable declines in responses from the prior quarter, and were surpassed in ranking order by development / construction costs (land, labor, materials). (Note: "Incorporating or competing with artificial intelligence (AI)" was added to the Q4 2023 survey, so a comparison to the prior quarter's results was not possible.)

Which of the following do you expect will be high priority issues in the next 12 months?



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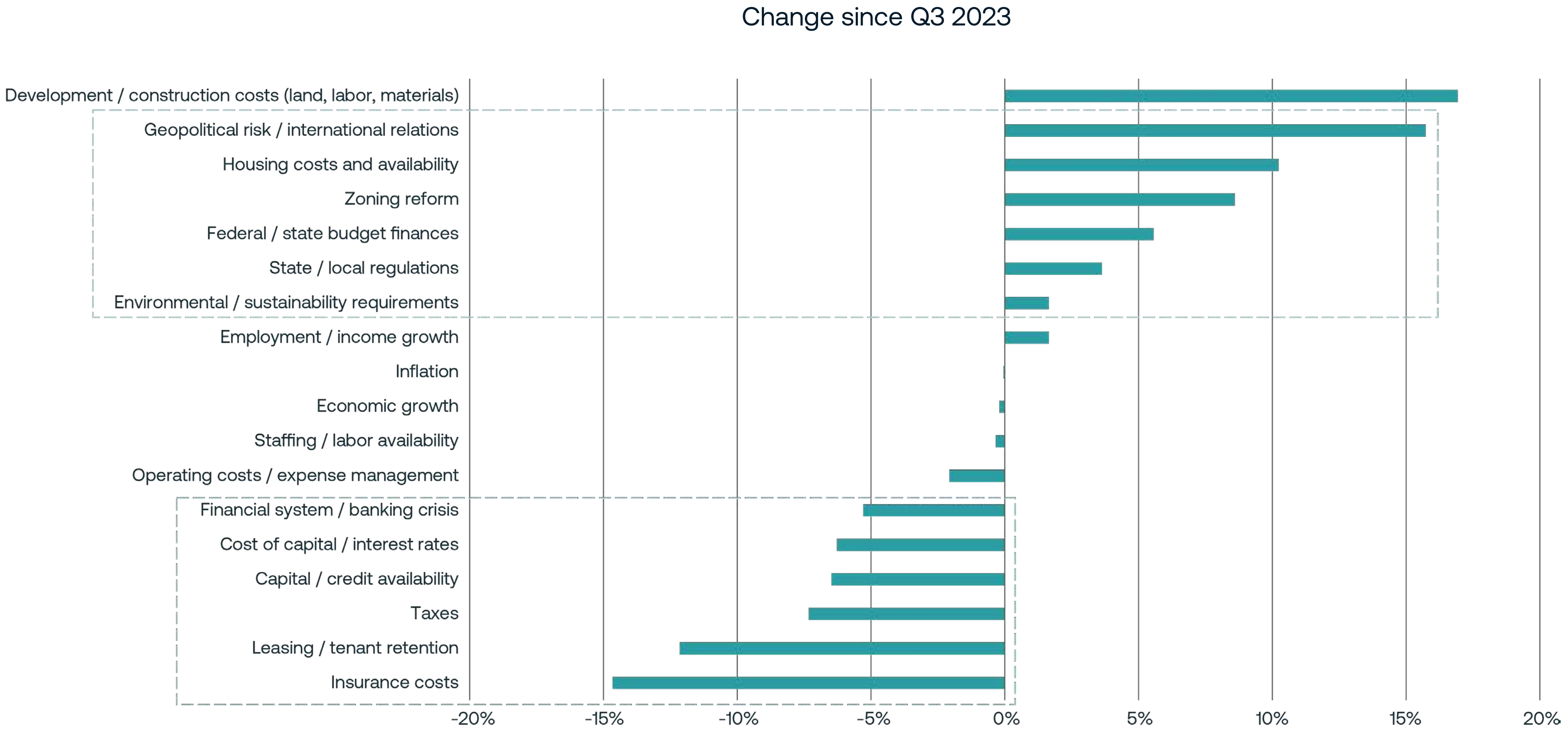
Priority issues over the next 12 months

Political/regulatory concerns become a higher priority. There were notable increases in rankings seen across many issues which are influenced or determined by non-CRE (exogenous) factors, including: geopolitical risk, zoning reform, federal / state budget finances, state / local regulations, and environmental / sustainability requirements.

Some signs of settling in, but still not comfortable – markets and operating issues remain. Participants noted moderate de-prioritization of financial system / banking crisis concerns, as well as concerns with cost of capital / interest rates, and credit availability, compared to the prior quarter's survey results. Cost management concerns, such as taxes, insurance, and tenant retention saw notable declines, too, but still remained as issues worth watching.

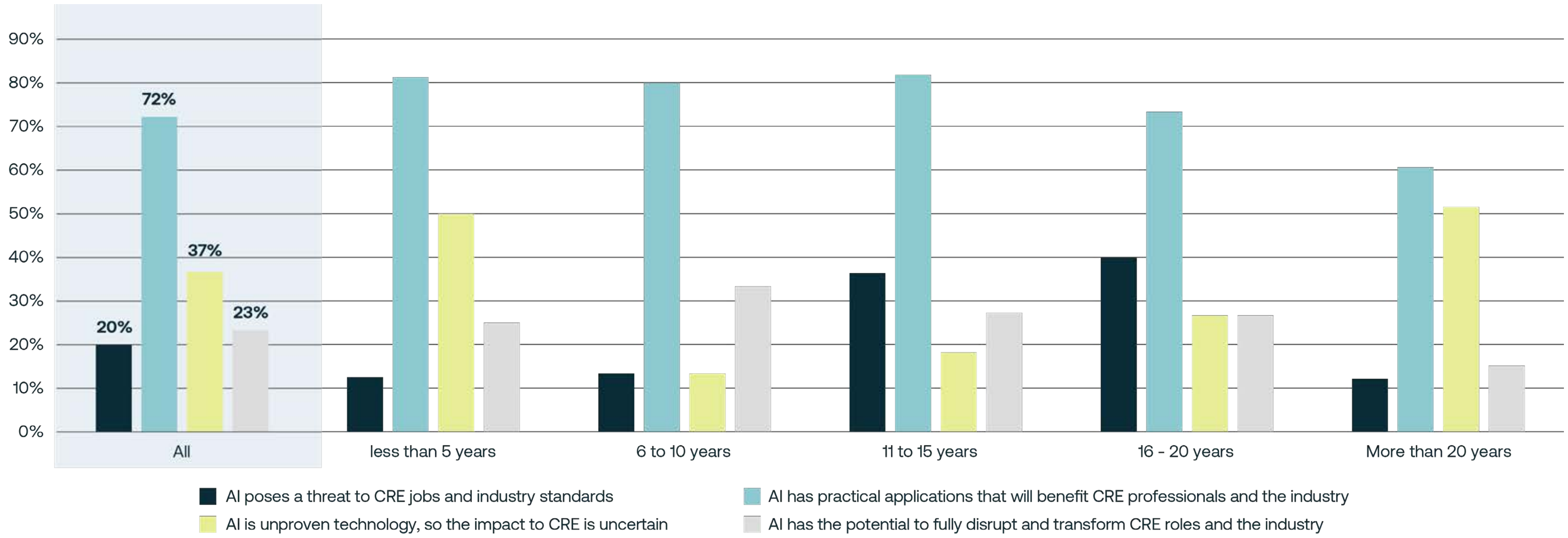


Note: Percentages represent the share of all responses, excluding "blank" or "not applicable" responses.

Artificial intelligence

The potential of AI is viewed as positive, but varies by industry experience. More than 72% of respondents reported that “AI has practical applications that will benefit CRE professionals and the industry”; however, this perception of beneficial practical applications of the technology declined with industry experience – nearly 80% of respondents with fewer than 15 years of experience viewed it this way, while only 60% of respondents with >20 years of experience held the same view. AI skepticism (“AI is unproven technology, so the impact to CRE is uncertain”) was approximately 37% of the responses, but was highest (around 50%) amongst novice professionals (<5 years experience) and veterans (>20 years experience). Finally, while overall responses show that one in five view AI as a threat, this perception was highest amongst the seasoned professionals (11-20 years experience) – jumping to nearly 40%.

In what way do you think artificial intelligence (AI) will affect the CRE industry? (by years of experience)



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