CRE Expert Predictions for 2024

CRE EXPERT PREDICTIONS FOR 2024

As 2024 begins, there is a sense of cautious optimism in the commercial real estate (CRE) industry after nearly two years of turmoil due to rising interest rates and the correlating contraction in lending and investment activity. The Fed's recent use of the term "rate cut" -- for the first time in this cycle -- added a much-needed boost to market sentiment in December. The prospect of rate cuts ahead came as welcome news after months of uncertainty. Despite the change in tenor, there are still a significant number of concerns that influence market sentiment and decision-making as the New Year gets underway.

This 2024 Predictions Report takes a timely look at what current market sentiment could mean for professionals across LightBox's broad client base of CRE lending, brokerage, investment, appraisal, and environmental due diligence sectors. The general consensus through the lens of the leading practitioners and industry influencers interviewed for this report is for a slow start to 2024 amid rising concerns about the fate of maturing loans, and guarded optimism for a busier second half as assets begin to change hands in a meaningful way, particularly if the Fed starts to lower rates. The bid-ask spread between buyers and sellers is beginning to narrow, and if transaction volume ticks up this year, it could accelerate the path to greater price discovery and reduce buyers' skittishness. The presidential election and international conflicts are among the top concerns clouding the forecast.

CRE Experts Interviewed

Victor Calanog, PhD., CRE, FRICS
Global Head of Research and Strategy/Chief Economist, Manulife Investment Management

Craig Benton, CRE, MAI, AI-GRS
Senior Director of Valuation Services Synovus Bank

Bob Knakal
Senior Managing Director, Head of New York Private Capital Group for JLL

Chris Powers
Founder, Executive Chairman of Fort Capital, and host of the Fort Podcast

Jon Winick
CEO, Clark Street Capital

Dana Wagner
CHMM, National Manager of Environmental Due Diligence Services, Terracon

Ryan Severino
Chief Economist and Head of Research, BentallGreenOak

Mike Flood
Senior Vice President, Commercial/Multifamily Policy and Member Engagement, Mortgage Bankers Association

Experts interviewed for this report expressed consistent opinions on questions about when deal flow would increase (the second quarter); which property sectors are at the top (industrial and multifamily) and bottom (office); and the concern over the uncertainty created by geopolitical issues. Opinions diverged on the possibility of a recession; the depth of despair in the industry and the impact of trillions of dollars in loan maturities on the banking sector, however.

"I've never seen a situation where the narrative is so far ahead of what's happening on the ground," said Jon Winick, CEO of Clark Street Capital, a bank advisory firm focused on loan sales, due diligence and valuation. *"There is a lot of doom and gloom, but the reality is things are healthier than market perception."*

And, as the country heads toward an expected divisive presidential election, there was no unanimous prediction on how different outcomes might impact CRE at large. However, all agreed that an election year presents a perfect opportunity for the Fed to lower interest rates.

The next 12 to 24 months will unfold as the fourth phase of the post-pandemic era -- with the industry slowly recovering after the initial shut down and stimulus efforts, and then the surge in consumer demand that drove up pricing and inflation, which prompted the Fed's aggressive intervention. The path forward could be choppy, as there are still significant challenges with price discovery and availability of debt and equity to refinance the massive number of loans coming due over the next several years.

THE 4 POST-COVID CRE MARKET PHASES

COVID Onset

2020

1H'20
New year optimism abounds until health crisis abruptly shuts down economy in March

2H'20
Gap starts to narrow between 2019 and 2020 metrics after COVID shock

Phase I: Stimulus, Early Recovery

2021

1H'21
COVID restrictions relax, injection of stimulus triggers recovery

2H'21
COVID variant injects brief uncertainty into recovery; year ends with record-high investment/lending volumes

Phase II: Record-High Surge

2022

1H'22
Robust activity fuels bullish forecast for CY'22; Fed's 1st three rate hikes trigger slowdown

2H'22
Four more aggressive rate hikes send investors to sidelines and prompt lenders to adopt risk-averse stance

Phase III: Rate Hike Disruption

2023

1H'23
Fed continues with three less severe rate hikes, market activity remains subdued

2H'23
As Fed pauses further interest rate hikes, attention shifts to new recovery phase in 2024

Phase IV Forecast: The Great Reset, Rebound

2024

1H'24
Hope of a midyear shift in monetary policy fuels optimism of interest rate declines, modest growth expected

2H'24
Assuming midyear rate declines and no unforeseen market shocks, investment/lending activity will rebound in earnest

TOP 5 CRE PREDICTIONS FOR 2024

1. Interest rates begin to drop by Q2

The latest Fed statement signaled a notable shift in monetary policy and a growing sense that rates could turn the corner and begin to drop by midyear.

2. Bid-ask spread will narrow as prices reset

Early signs are emerging that the bid-ask spread between buyers and sellers that impeded deal flow in 2023 is starting to narrow, and as it does, price discovery will improve and buyers will be less skittish.

3. CRE lending and dealmaking to rebound by midyear

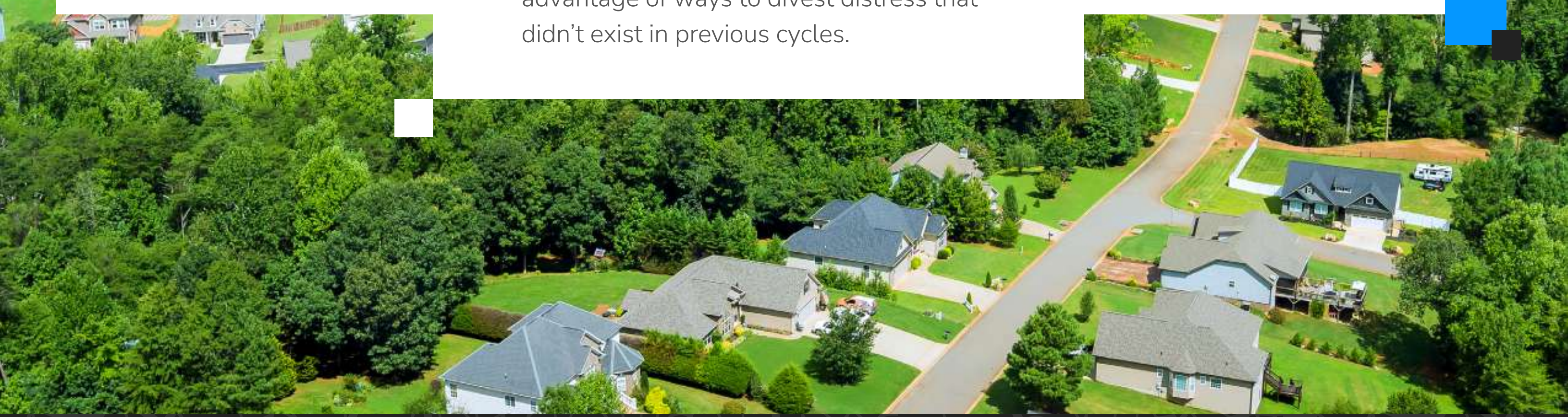
CRE volume to slowly increase by midyear as the fog surrounding property values lifts and market confidence improves.

4. Treasury rates stabilize at 3.5%-4%, heralding revitalization by year-end

Treasury rates, tied to borrowing costs and cap rates, will stabilize by midyear, sending a positive signal to investors and lenders that capital can safely move back into play.

5. Distress ahead, triggering secondary market loan sales

As more CRE loans reach maturity and are challenged to refinance, secondary market loan sales will increase as lenders take advantage of ways to divest distress that didn't exist in previous cycles.



1. INTEREST RATES TO DROP BY Q2, TRIGGERING NOTABLE SHIFT IN SENTIMENT

While the Fed's December rate hold was widely anticipated, it did come with a welcome surprise for the CRE industry -- the prospect of three rate cuts, and maybe more, this year. The news signaled a notable shift in monetary policy, after 11 interest rate hikes over the past 2 years put the brakes on investment and lending activity. Barring any unforeseen market shock, there is now a general sense that rates could finally turn the corner and begin to drop by midyear.

Some industry forecasters predict as many as five or six rates cuts this year, but it is important to keep optimism in perspective. *"The market forecasts right now are pricing in a little too much optimism,"* said Victor Calanog, PhD. CRE, FRICS, Global Head of Research and Strategy/Chief Economist at Manulife Investment Management. *"Rate cuts of 250 to 275 basis points would assume an economic dislocation."*

All eyes will remain on the Fed as it balances a strategy of loosening monetary policy with continuing to curtail inflation. The timing of the first rate cut will be very telling in terms of triggering any measurable uptick in commercial property deals, and market perception will be an important element in convincing the industry that it's safe to go back in the water. *"From a commercial real estate point of view, we don't necessarily need the Fed to start cutting rates. We just need them to stop raising rates,"* said Ryan Severino, Chief Economist and Head of Research at BentallGreenOak. *"And, of course, the market has to sincerely believe it."*

2. BID-ASK SPREAD WILL NARROW AS PRICES RECALIBRATE

One of the key factors that impeded CRE deals in 2023 was the bid-ask spread and lack of price discovery. The good news is that there are early signs of the gap starting to narrow, and as it does, confidence in closing deals again will improve. *"Transaction activity is slowly coming back as there is some confidence that rates have stabilized or there is a perception that values are at a new level,"* said Winick.

Still uncertain is the extent to which prices will reset. Valuation declines in the teens to 40%-50% are not out of the question, Winick noted. Investors are often looking at 5-to-20-year horizons which allows time for an asset to appreciate beyond an elevated purchase price. However, price uncertainty coupled with rising interest rates and changing fundamentals across asset classes has complicated the mechanics of closing deals. From an appraisal perspective, *"The market hasn't seen values drop off because there haven't been any sales that would reflect it,"* noted Craig Benton, CRE, MAI, AI-GRS, Senior Director of Valuation Services at Synovus Bank. *"We all know the cap rate on an apartment transaction is not 4.5%, but what is it? What is generally seen in an appraisal today is older sale data, so we have to look at data that is available and get market surveys, talk to brokers about offering packages and what they are seeing in the bid-ask spread to get to cap rate."*

In the current environment, *"price discovery will occur as sellers capitulate,"* said Bob Knakal, Senior Managing Director, Head of New York Private Capital Group at JLL. *"This happens when folks have to sell or have very compelling strategic reasons to make a move, with most of these strategic reasons revolving around portfolio realignment."*

3. CRE TRANSACTION AND LENDING VOLUME TO REBOUND BY MIDYEAR

As the fog surrounding property values lifts, lenders and investors will be more comfortable penciling out commercial property loans again. Calanog expects that 2023 data will show a 46% drop in loan originations to around $440 billion and a 45% drop in transaction volume for the year below 2022 levels, but then a bit of a recovery by the second quarter of 2024. *"I predict that loan originations will reach $555 billion this year. That would be an increase of about 27% over last year, but still below what we saw in 2021 and 2022,"* he said.

Calanog's forecast is consistent with the latest Mortgage Bankers Association projection. *"Although there is still a tremendous spread between the bid and the ask, as rates begin to settle and refis become necessary, we will start to see deals in the marketplace,"* noted Mike Flood, Senior Vice President, Commercial/Multifamily Policy and Member Engagement, Mortgage Bankers Association. *"Once we have a few solid valuations and hopefully steady rates, we will see lending rebound in earnest. Assuming no exogenous events, I'm hopeful for more lending volume by the second half of 2024."*

Industry experts also expect CRE volume to slowly increase by midyear, *"then the flood gates will open up,"* said Severino. *"Given the uncertainty in the market and loans to work out, it's not like flipping a switch, but we will be in a significantly better place at the end of 2024."*

This will be a refreshing change of pace for many who struggled to close deals in 2023. *"There's been a year of challenging efforts to structure capital calls and make deals work, and it hasn't worked as well as people had hoped,"* said Chris Powers, Founder and Executive Chairman of Fort Capital and host of the FortPod. *"Lenders are just not lending as much. They say there is all this dry powder on the sidelines, but I just don't see it moving right now."*

4. TREASURY RATES TO STABILIZE AT 3.5% TO 4%, HERALDING REVITALIZATION BY YEAR-END

For some, including Calanog, more important than interest rates is where the U.S. Treasury will land. There is an important relationship between yields on the benchmark Treasury bond, borrowing costs and property values—and therefore, market confidence. Cap rates typically move up with any sustained rise in the Treasury yield, and higher cap rates are associated with lower property values across asset classes. The 10-year Treasury yield is also an important measure of borrowing costs for various types of debt, including CRE loans so as it rises, the cost of capital rises and triggers lenders to adopt a more cautious stance.

By early November, the 10-year Treasury yield landed at 4.8%, its highest level in 16 years. Thus, analysts as well as cautious buyers are now closely watching recent movement in the Treasury rate benchmark in an uncertain market environment. Calanog expects the 10-year U.S. Treasury rate to stabilize between 3.5% to 4% by the end of the year, and that *"should spur some recovery in activity, including some repricing on the debt side, but also a repricing on the asset side, which will herald some revitalization."* On the flip side, any sustained increase in the Treasury rate that moves it closer to 5% could point to economic instability, a retreat by lenders, and an erosion in investor sentiment.

5. SECONDARY MARKET LOAN SALES TO INCREASE AS DISTRESS RAMPS UP

Despite talk of a tsunami of distressed assets in need of refinancing in the pipeline, the high cost of capital and market uncertainty have kept distressed deals low thus far. *"We keep hearing about this $4 trillion in commercial real estate that needs to be refinanced, but I haven't seen a surge in activity,"* said Benton.

While the huge wave of distress has not yet materialized, the market is poised to react as more loans reach their maturity dates and are challenged to refinance. Losses in the banking sector are also likely due to lower asset valuations, particularly in the office sector, which is struggling with low occupancy rates as more employees work remotely.

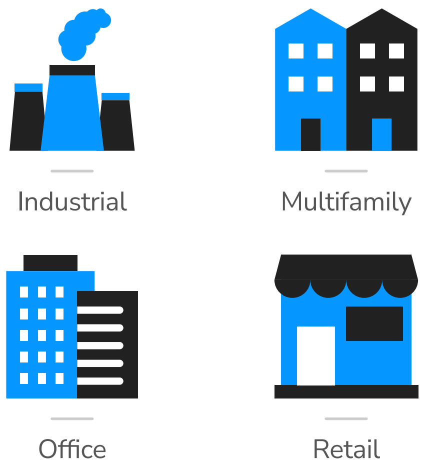
"We really saw distress accelerate in the fourth quarter of 2023, especially in certain commercial real estate sectors where owners were starting to throw the keys back," said Powers. *"Some were losing confidence that they had much of an opportunity to create the value they needed with those assets."*

For environmental due diligence consultants who support lender clients, there are definite challenges ahead. *"What worries me for 2024 is the amount of commercial property loans with challenges,"* observed Dana Wagner, CHMM, National Manager of Environmental Due Diligence Services at Terracon. *"There are still many people looking for financing for commercial loan maturities that are coming due and they're going to have to figure out creative ways to do it, whether it's a workout or bankruptcy or finding an investment partner."*

The time horizons on problem credit are a concern for many property owners, as there are challenges selling assets in this high interest rate environment. *"Even if banks want to work with the borrower, the time horizon on problem credits is one to two years and there are bigger concerns with the office sector,"* said Winick. *"This all makes the exit more challenging and elongated—and potentially more painful."*

In this current cycle, there are more ways to handle distressed assets, said Winick. *"We're seeing an uptick in secondary market loan sales due to more awareness of the ways to divest distressed loans that didn't exist in previous cycles."*

WHAT'S AHEAD BY PROPERTY SECTOR?



The nearly two-year cycle of interest rate hikes has exposed the strengths and weaknesses of the various CRE sectors, as well as their ability to adapt and endure in the face of economic challenges and shifting workplace dynamics. Industrial and multifamily continue to reign as the top asset classes, due to their strong fundamentals and demand drivers. While both sectors have experienced some decline in rental rates and supply-demand balances, they are still widely considered safe bets for long-term asset appreciation.

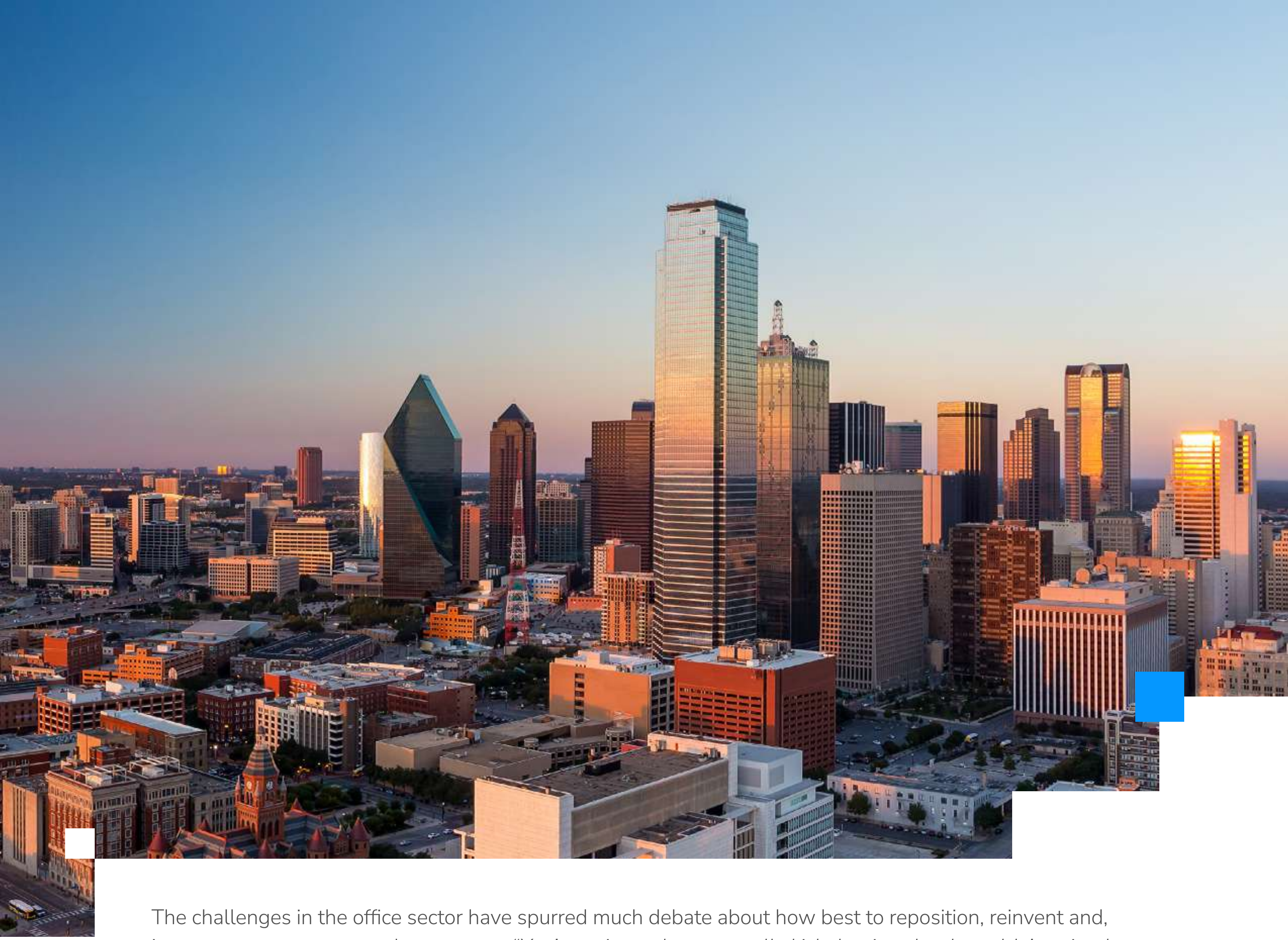
The industrial sector continues to drive significant leasing and investment activity due to the important role it plays in e-commerce, manufacturing, and logistics. The multifamily sector is benefiting from the housing shortage that has driven more people into renting, as well as the wide spread between the cost of renting and the cost of buying. That spread has reached an historic level at almost $1,000 per month. *"Something has to give -- either home prices are going to fall, or rents are going to go up,"* said Winick. *"I think there will be opportunities in the multifamily sector and opportunities to convert some MF properties into residential condos."*

Retail, which survived many blows during the pandemic, has emerged as a dynamic asset class through responsive, aggressive, and creative reinvention concepts. Brick and mortar retail no longer is doomed as a casualty of e-commerce; instead, it is a partner in the expanding omnichannel experience. Further it has become increasingly more common for mall owners to incorporate housing components into the footprint and embrace new "eatertainment" concepts that help attract consumers.

At a more local level, grocery-anchored centers remain a popular, need-based investment choice. As more grocery store chains eye expansion and penetration in strong markets, some of the smaller chains represent options for replacing big box stores and other shuttered spaces, particularly in suburban locations with high work-from-home populations.

"I'm bullish on grocery anchored retail as long as you don't build too much shop space in the center as that will dilute your performance," said Benton. *"I feel like grocery is a safe space because we all have to eat and many people make smaller trips to the grocery store multiple times per week. The key is having inline service tenants there to round out the project."*

Conversely, the office sector is seen as the losing asset class, yet no one is counting it out yet. Given the pervasive work-from-home dynamic that has pushed occupancy levels as low as 50% in many markets, a deep divide has formed between the haves and have nots. This dynamic will likely exacerbate the trend of tenants scaling back space. *"The office dichotomy of physical occupancy and contractual occupancy is expected to converge,"* said Winick. *"You can't have 80% occupancy when only 50% are going to the office."*



The challenges in the office sector have spurred much debate about how best to reposition, reinvent and, in some cases, repurpose those assets. *"You're going to have to really kick the tires, but I wouldn't write the entire sector off entirely,"* said Calanog. *"The best assets in the best locations owned by reliable sponsors, financed with innovative capital structures from investors, will drive transaction activity."*

While there is much debate about converting office buildings to residential, there are misperceptions about the challenges with reconfiguring a commercial building for residential use. Only around 10% of those conversions are realistic given structural, location and cost issues. Those redevelopment projects that do get off the ground, however, can take a few years to cycle through zoning approvals and construction.

"The key to reinventing office space is to make the space inviting enough where people want to be there and be productive," said Severino. *"It's like those blurry third spaces we see in hotels and apartment buildings; spaces that are not work space and not relaxation space, but social environments that create communities. People want places to go hang out and work but they don't want it to be a cubical farm."*

Hospitality is also viewed more negatively now that the post-pandemic "revenge travel" surge has subsided and business travel remains constrained. And, senior housing is a concern, given some fundamental issues with skyrocketing expenses and the challenges of boosting rents while relying on government reimbursements. However, that sector does benefit from the large aging population and the more limited supply of nursing homes.

PREDICTIONS ACCORDING TO THE EXPERTS

Victor Calanog, PhD., CRE, FRICS

Global Head of Research and Strategy/Chief Economist, Manulife Investment Management

Where Interest Rates Will Land

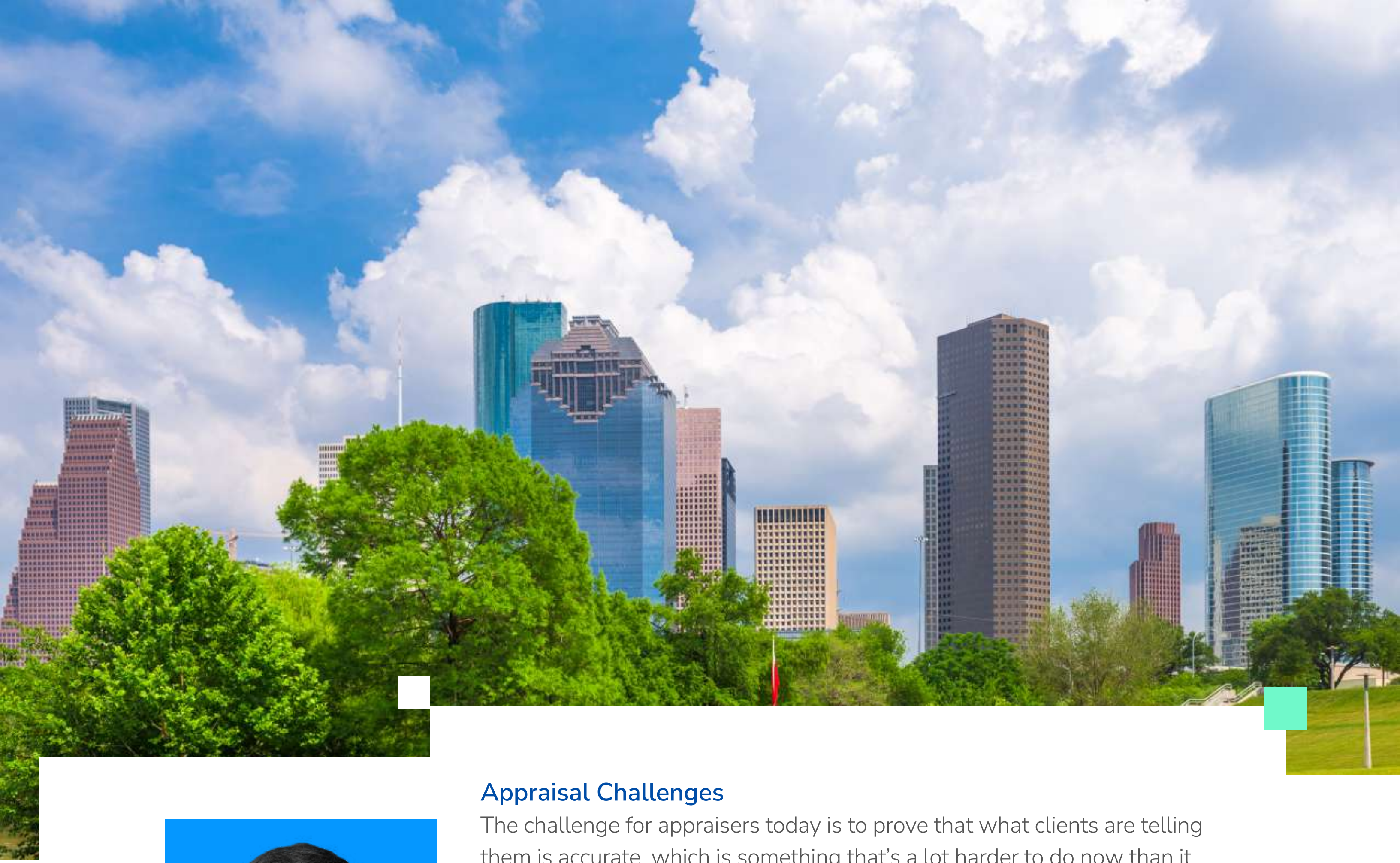
I expect to see some kind of rate decline in 2024. If I had to make a call as to the equilibrium interest rate at which the U.S. economy is balanced between expansion and contraction, my (nominal) estimate is around 2.5%. If the Fed hits its 2% inflation target, that means the long-run neutral rate is really at or around 0.5%. This is consistent with what the Fed is forecasting.

Office Market Outlook

While the U.S. office market is suffering through significant challenges, office is doing well in Europe and Asia, where physical occupancy is back to between 90% and 100%. The way we learn and interact in North America is very different than in other parts of the world where information tends to be transmitted in a tacit way, as opposed to codified. Proximity doesn't matter as much if you can send information and promote learning via a PDF attachment. But if a lot of how information is transmitted, and learning is generated isn't codified – then proximity to each other means the typical office environment still provides benefits.

What many workers are missing out on is the connection between coming to the office and mentoring, training and career-building relationships. The younger generation may become the force that pulls middle level managers back into the office, not just because the executives say you need to go in, but because they need to teach their people, who are eager to learn.

I don't think that converting office to other uses is going to be the panacea people are thinking about. Office conversions to residential are not easy. We estimate that less than 10% of office inventory around the country may be eligible for successful conversions. And even then, it will likely require government support for the numbers to pencil out.



Craig Benton, CRE, MAI, AI-GRS

Senior Director of Valuation Services, Synovus Bank

Appraisal Challenges

The challenge for appraisers today is to prove that what clients are telling them is accurate, which is something that's a lot harder to do now than it was a couple of years ago. As far as the price point, appraisers might come in with a price per square foot and cost approach. It isn't great, but if it's done well, it can be all right.

This underscores the importance of internal stress testing. And, the question mark is always, what cap rate should be used for the stress test? What is a reasonable number to use without penalizing it too heavily, but that reflects the risk that may or may not be present?

A Look Ahead

- There is debate over a recession, but it hasn't happened yet. It's not going to be a real estate led recession. We're not going to have 40% drops in values across the board like we saw in the last financial crisis. Obviously, there are certain asset classes, such as office, that will take a heavy hit, but valuation drops will be very market and sector specific.

- Interest rates are going to stay where they are until midyear 2024 and then the Fed will have to start cutting rates or we will really be digging in pretty deep.

- The majority of the home buying and selling is driven by people who have to make a move. There's a heavy spill over into commercial real estate and the significant drop in transaction volume. Our customers who are single family residential (SFR) realtors and appraisers are experiencing significant reductions in year over year cash flows.

Interest Rates in 2024

Interest rates will have to come down to unglue these deals. Nobody wants to do deals at a 7% to 8% interest rate, but if rates go down to 6%, it will loosen things up.

Interest Rates

I expect rates to ease in the first half of the year. As importantly, this signal and the correlated confidence that comes along with it, means that lenders should start to compress spreads as the market to put out capital becomes more competitive.

Bob Knakal

Senior Managing Director, Head of New York Private Capital Group for JLL

Seller Capitulation

In past market cycles, it typically takes 12 to 18 months for sellers to become in-tune with the new market and after that, capitulation occurs. Recent investment sales in the New York City market suggest that this capitulation phase may have already begun. In Q3'23, Manhattan property sales over $10 million dramatically increased, at a quarterly volume that was nearly double each of the totals from the first two quarters of the year. The Fed dropping rates will have two impacts – one good and one bad.

- The good? The uber wealthy investors who have been waiting for the bottom will now be ready to purchase.

- The bad? Sellers will do all they can to hold as they wait for further drops in rates and hope for increases in values.

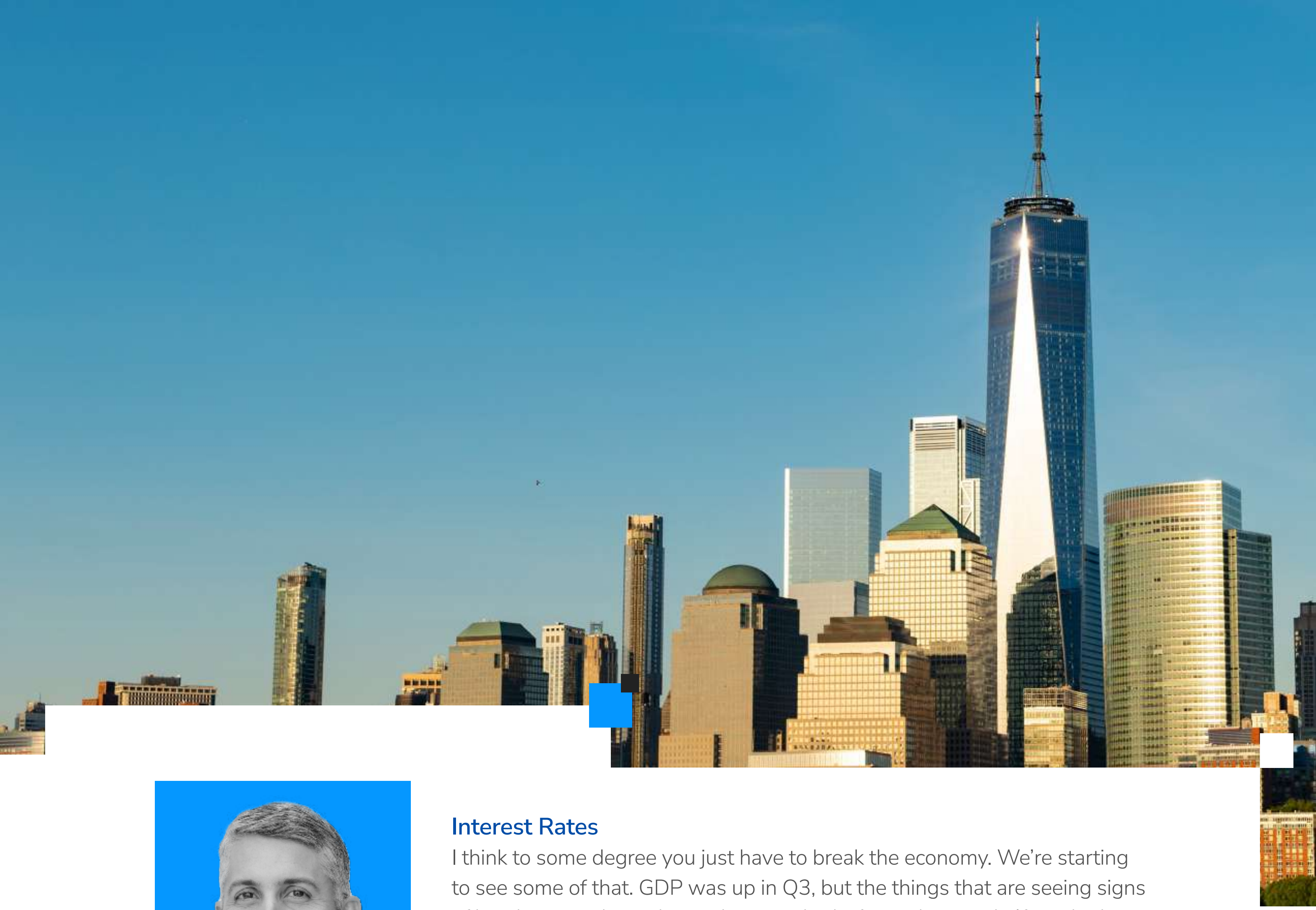
The best-case scenario is that rates drop more than expected. In an election year, this would not be a surprise. When interest rates go up, it's not necessarily bad for real estate (depending on what's going on in the broader economy) but when they come down, it's always good for real estate.

Green Shoots

Among the hidden areas of opportunity are the land market, which is the biggest opportunity in New York City today. Land values are significantly lower today and, at the next cyclical peak, they should be at least double where they are today.

Fun Prediction

Maybe someone will sell a New York City building in exchange for Bitcoin.



Chris Powers

Founder, Executive Chairman of Fort Capital, and host of the Fort Podcast

Interest Rates

I think to some degree you just have to break the economy. We're starting to see some of that. GDP was up in Q3, but the things that are seeing signs of breaking are those things that people don't need as much. If you look at noncore items people don't need as much, like second homes, high end dining, and luxury vacations. Those areas are starting to show weakness.

Office sector outlook

There is very little market for office right now and it's a big deal that a lot of the country thinks they don't have to go back to an office again. These are big assets that traditionally require a lot of money to capitalize and there is a lot of money in them and everyone is struggling to figure out what will happen to them. This will be going on for decades in terms of repositioning these buildings.

Predictions

- If you look at REITs, you'll see that property values are down 30% to 40%. Values will be down at least another 10% to 15% next year. While it will vary by asset class, with office having the most trouble, values next year may be down across the board until Q3 or Q4.

- Industrial has held up really nicely throughout all of this and I think industrial will be the leader in the recovery.

Before we see a return to normal activity, the industry will have to reboot mentally and get the engines going. There is also a lot of focus on working out loans and that is taking time away from traditional deal making.

Disconnect between Sentiment and Reality

While the banking sector is experiencing significant challenges, the sentiment on the street is more negative than the reality. Yes, there is a storm coming in the lending sector, but it's unclear whether it will be mild or severe. For banks with underwater securities or the need to raise capital, it won't be easy and it may force them to lose their independence. The good news is that it's coming at time where bank's capital positions are quite strong. Most institutions will be able to navigate themselves to the other side.

Jon Winick

CEO, Clark Street Capital

The challenge is identifying how much influence banks have in mitigating the storm with respect to funding. The recent quarterly bank profile was somewhat encouraging from a funding standpoint, showing that banks' margins actually grew.

How Today is Different from the GFC

We're in a very different environment than the Great Financial Crisis when you had loans in which the properties were underwater, but the rates were low enough for borrowers to make payments on it. Today, it's the opposite. The loan sale industry should be robust in 2024 and beyond because:

- Many sellers are now aware of the strong and diverse market for loan sales.
- Hold periods for substandard loans will be elongated due to the lack of credit.
- The cost of carrying bad paper is elevated.
- There is a need for liquidity.

In the near-term, interest rates will continue to be elevated until inflation is in the rear-view mirror or there is a recession, which will create its own set of issues. This idea that you are going to have a soft landing and rates will come down without a recession is very unlikely.

Predictions/Outlook

The best-case scenario is that consumer spending stays strong, the economy never enters a recession and inflation continues to come down and there is a gradual lowering of rates to the point that people feel like they can transact again.

The worst-case scenario is that rates stay elevated for so long that we enter a severe recession, fundamentals are stretched and the lenders are too battered from the stress of their own portfolios that they can't put out enough money and we end up with another 2008.

It's difficult to understand how banks can mitigate the potential hit to earnings next year. While it's difficult to estimate a number, there certainly are going to be a number of banks that are unprofitable.

Dana Wagner

CHMM, National Manager of Environmental Due Diligence Services, Terracon

Market Sentiment

I expect to see the market begin to pick up in Q1 or Q2 of 2024, which is in line with my sentiment from midyear 2023.

We started 2022 really strong and were on a record pace for environmental due diligence activity until midway through Q3, which is understandable given the 50% drop in commercial mortgage activity, but I do see signs of improvement. Like many others, we saw a slowdown after that. The last year has produced many challenges, but companies such as ours that have a large and diversified market presence are better positioned for a softer landing. When you look at year-over-year comparisons, at present most of our practice areas see revenue growth despite all the challenges. We work with a lot of the major lenders and there's been some improvement in activity—nothing to write home about, but better than earlier in 2023. We are seeing investor clients positioning themselves for more activity in 2024. Some of it is opportunistic and some of it is alternative financing.

Key sectors

- Multifamily will remain favorable in 2024. The housing stock is still under pressure as people remain in their homes due to higher interest rates and more expensive construction materials and labor costs. That said, single family housing starts have been recovering, but significant overall movement on single family housing availability will only occur when interest rates drop, which is now being forecast for 2024.

- We are bullish on industrial and digital services. There is going to be a reconciliation on the office side. Earlier in this cycle, people were expecting office to work itself out and that people would be back in the office in a bigger way. This isn't going to happen. I think there will be opportunities in the repurposing side with office, but it depends on where, what the plan is and whether the cost structure works.

- For the environmental business, there is a geographic aspect to what we expect to see. I still think the Sun Belt will be pretty good, but there are some spots that are brighter than others. Dallas/Fort Worth, Houston, Nashville, Phoenix and Atlanta should be strong. There are also above the "Belt" bright spots including Boston and Seattle.

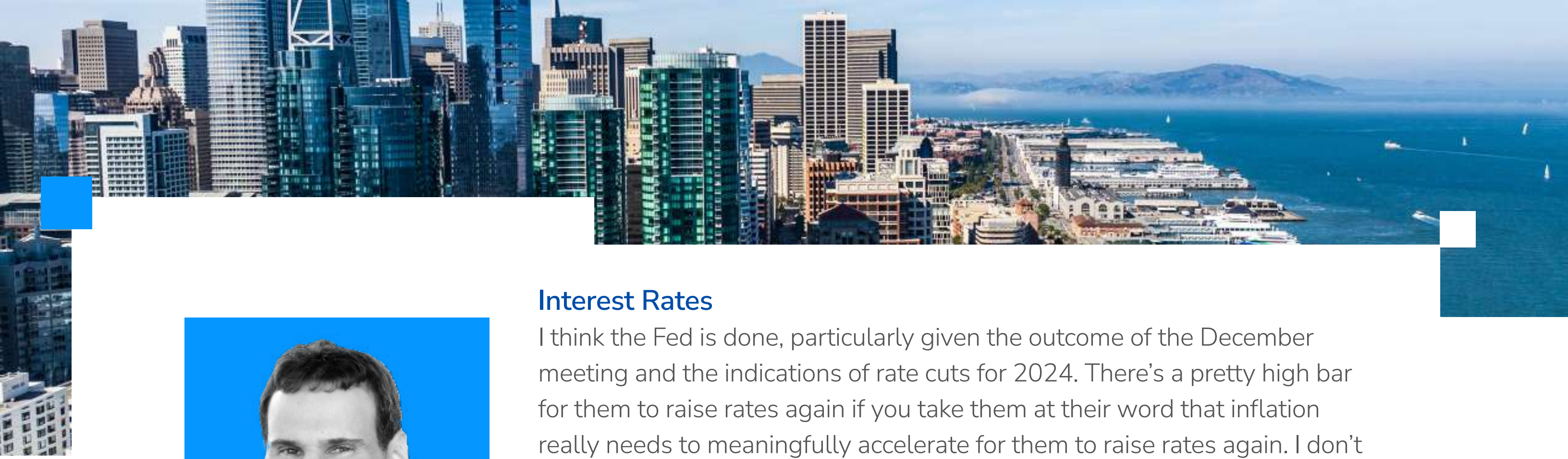
Climate Risk

We view climate risk as one of the biggest growth areas for our business, with a subset of companies that are asking for it specifically. From the investment and lending communities, they are moving in that direction, but I feel many are waiting for the shoe to drop when it becomes a regulatory requirement.

AI Impact

My prediction is AI is going to have an outsized role in the business by the end of 2024. I do feel that this idea of alternative delivery of information is something whose time is here and is going to get more and more important with clients requiring near real-time input on their decision-making. AI is hugely important in how we can apply it in the service of their customers. Those companies that have a robust data management structure are the ones who will be able to respond and differentiate more quickly.

There are some cautionary elements to AI. For instance, I don't think it replaces good counsel at this point. It can be a persona in the room but not the thing that is really driving conversation on what should be done. At least in the near term, there will absolutely be a need for people to check this and understand it. I do think it's important to have the ability to vet the response. You really have to be really careful, but I think you'd be foolish to relegate it to…"it's coming." It's already here. We just have to be able to manage it.



Ryan Severino

Chief Economist and Head of Research, BentallGreenOak

Interest Rates

I think the Fed is done, particularly given the outcome of the December meeting and the indications of rate cuts for 2024. There's a pretty high bar for them to raise rates again if you take them at their word that inflation really needs to meaningfully accelerate for them to raise rates again. I don't see inflation re-accelerating.

Rate cuts feel like a second half of the year phenomenon to me. I don't expect the Fed to cut rates in the first half of the year. I think they're going to be circumspect about it, but they want to make sure we are truly headed back down.

Five rate cuts in 2024, as many have predicted, feels like the markets getting over their skis to me. I don't think the Fed wants to be in a position to then have to raise rates again. The more likely scenario is that they'll leave rates hovering around 5.5% for a while, unless the wheels really fall off the economy in a way that I don't anticipate.

Unless the Fed overshoots, and I don't think they have, then I don't think we will land in a recession. I do think things will slow down. You can't raise interest rates 550 basis points without there being some restriction on the economy.

If we can get to a point where the commercial real estate market has confidence and appreciation, we will be back to positive total returns. When that happens, the market will be in a much more favorable position than it's contended with over the past four to five quarters.

The Future of Office

I think of office in terms of two dimensions. We were already seeing this bifurcation between the haves and have nots. That kind of uncertainty existed before and people were deciding what to do before, but now they know. Part of the market will emerge as the winner and the part that was struggling before will go in another direction.

Inflation and the Labor Market

I think that inflation is on its way down. The convention is to always look at inflation year over year, but that always incorporates a lot of stale information. If you look at it on a shorter basis, one-month annualized or three-month annualized or six-months annualized, you'd see that it's down significantly.

The labor market is also slowing down, which was bound to happen. It's proved a lot more resilient than a lot of people thought. You want to slow things down but not enough that it will cause trouble. The bottom is not dropping out of the labor market just yet. We can slow this down and it will get a little bit bumpy.

The Draw of Industrial

I'm still the most optimistic about industrial, and it's not just about the tremendous growth in e-commerce during the pandemic. Industrial is going through a significant transformation and now you have a property type that is part of a very sophisticated, technologically-oriented global supply chain, and, because of that, it now has more value to the global economy.

Mike Flood

Senior Vice President, Commercial/Multifamily Policy and Member Engagement, Mortgage Bankers Association

Interest Rates

The Fed is calling for rates to stabilize with a few drops next year. Our economist is calling for rate drops starting in the second half of next year. Personally, I'm paid to be paranoid. So, I'll agree, as long as there are no more exogenous events – such as another war-like event.

Rising Property Insurance

Shockingly, the top concern for MBA's members is the ability to both obtain and pay for property insurance. It has gotten to the point in states like California, Florida, Texas and Louisiana that deals are falling through due to the lack of availability of the proper amount of insurance. After that, a top concern is the ability to produce affordable rental housing, and making sure Federal regulators find the proper balance for regulating financial institutions vs. producing commercial real estate loans.

Bank Regulation

The regulatory focus is currently on a few key areas: safety and soundness, the production of affordable rental housing, and climate change resiliency. While all three issues are important, it is important that any new regulation is supported by facts and data. The December visit to the Hill by bank representatives was to tackle that very issue. The Basel "Endgame" rule aims to create a safer banking system by increasing capital. While that is a laudable goal, the 1,100 page regulation has roughly three pages of analysis, and it is exceptionally difficult for the industry – let alone any outside analyst—to see how a 10%-20% capital raise is justified from three pages. That said, the risk-weights that are solely focused on commercial real estate loans do appear to be positive for the banking industry, if implemented. With a divided Congress heading into an election year, we can expect most issues that affect commercial real estate to begin and end with the regulators.

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