

Economic Update

 **SVN** | Research

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1. ECONOMIC ACTIVITY REMAINS STEADY

- According to the October 23rd release of the Federal Reserve's Beige Book Summary of National Economic Activity, activity has changed little in nearly all districts since early September, though two districts have reported modest growth.
- The latest Beige Book provides an additional glimpse at how the US economy has performed in the weeks leading up to and following the Fed's interest rate pivot.
- In early September, macroeconomic and labor data persuaded some observers, including many Fed officials, that it was time to move into a more accommodating stance with slowing inflation and economic activity.
- In the weeks following the cut, robust jobs data and a slight acceleration in consumer prices have dampened the worries surrounding growth and caused markets to rethink their interest rate projections. Treasury yields have grown, showing that markets expect a higher new normal for interest rates.
- Nonetheless, the relatively unchanged nature of economic activity, according to the anecdotal Beige Book, offers little clarity on the question. Economic sentiment was surveyed between August 27th and October 18th, with the interest rate cut coming in the middle of the survey period and unlikely to have significantly impacted week-to-week activity shifts.

2. MORTGAGE DEMAND & INTEREST RATES

- Mortgage applications fell by 6.7% during the week ending on October 18th, according to the latest data from the Mortgage Bankers Association. It was the fourth consecutive weekly decline.
- New mortgage applications fell roughly 5.0% during the week, while refinance applications fell 8.5% week-over-week.
- The latest data comes one week after a sharp 17% drop in overall mortgage activity and is in line with the increases in benchmark interest rates that have occurred since the start of October.
- The ongoing acceleration in benchmark rates is in reaction to strong recent solid economic data such as the September jobs report, and better-than-expected retail sales, and unemployment claims data, with Treasury markets reflecting doubt that the Fed will cut rates as quickly as markets were previously

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pricing in.

3. DEBT MARKET OPPORTUNITIES IN THE OFFICE MARKET

- Work-from-home headwinds and elevated interest rates have stifled the US Office sector — but a recent report by Hines delves into why an upcoming wave of loan maturities may create an opportunity for new funding mechanisms.
- The analysis discusses signs of higher-quality office assets performing well in the new work-from-home normal. Class A buildings represent roughly 27% of the US Office stock.
- With valuations down and the work-from-home shift largely priced in, the risk is falling for newly originated loans, and lower LTVs could mitigate the risk of any principal loss. Higher yields on debt may also provide further cushioning.
- As property owners look to fill the gap between equity and what is likely to be smaller senior mortgages, funding opportunities in the mezzanine are likely to multiply, the analysis finds.

4. RETAIL SALES

- Retail sales jumped by 0.4% between August and September, a significant increase above the 0.1% monthly rate recorded in August and beating consensus forecasts of a 0.3% rise.
- Misc. store retailers recorded the most significant jump in sales, rising by 4% during the month. Clothing sales were up 1.5%, health and personal care sales were up 1.1%, and food and beverage retailers saw a 1.0% increase.
- Other retail groups experiencing month-over-month increases in sales growth include food services and drinking places (+1.0%), general merchandise stores (+0.5%), non-store retailers (+0.5%), sporting goods, hobby, musical instrument, and bookstores (+0.3%), and building material and garden equipment supply dealers (+0.2%).
- Conversely, electronics and appliance store sales fell by 3.3% month-over-month, while gas stations and furniture stores experienced declines of 1.6% and 1.4%, respectively.

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5. CMBS DELINQUENCIES JUMP

- CMBS Delinquencies continue to climb across all property types, with the indicator tracked by Trepp up 26 basis points to 5.70% in September. The delinquency rate is up 131 basis points over the past 12 months.
- The Retail sector was a key contributor to the increase, accounting for roughly 50% of the monthly rise in the headline rate. The Retail delinquency rate rose 86 basis points in September to 7.07%, its first time crossing the seven percent threshold since April 2022.
- Office accounted for 37% of the \$2 billion increase in overall delinquent loans in the CMBS market, up 39 basis points to 8.36%.
- Lodging and Multifamily delinquencies also climbed, up 32 and 3 basis points respectively.
- Industrial was the sole sector to see a decline in delinquencies, falling eight (8) basis points to 0.32%.

6. COMMERCIAL FORECLOSURES

- According to the most recent monthly US Commercial Foreclosures report by ATTOM, while commercial foreclosures appeared to have peaked in May 2024, they remain elevated over pre-pandemic figures.
- Foreclosures began steeply rising in June of 2023 before peaking at 752 in May 2024. In September, ATTOM registered 695 commercial foreclosures, a modest rise from summer numbers, suggesting that foreclosures may settle into higher equilibrium while CRE dynamics continue to transition.
- According to historical data, foreclosure activity has seen large fluctuations over the past decade shaped by economic conditions and structural shifts, such as during the COVID-19 pandemic. The decade high remains an October 2014 total of 889 before foreclosures began to decline during the latter half of the 2010s.

7. CONSUMER SENTIMENT

- According to preliminary estimates, the University of Michigan Consumer sentiment index declined in October to 68.9 after reaching a five-month high of 70.1 in September and arrived slightly below a forecasted level of 70.8

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- October ends consecutive monthly increases for the index, which experienced a relatively steady decline across the first six months of the year. The index started the year at 79 points in January and reached a year-to-date low of 66.4 in July.
- Both the current conditions and the expectations sub-indices weakened in October.
- Year-ahead inflation expectations rose slightly to 2.9% from 2.7% the month before, aligning with the slight uptick in price pressures experienced between September and October.
- The five-year-ahead outlook for inflation eased from 3.1% to 3.0%.

8. INDEPENDENT LANDLORD RENTAL PERFORMANCE

- On-time rental payments in units operated by independent landlords jumped higher in October 2024, reversing a trend of four consecutive declines.
- An estimated 85.5% of tenants in independently operating rental units completed their monthly payments on time. The on-time payment rate improved by 30 basis points (bps) from the prior month, though it remains down by 79 bps from the same time last year and 275 bps from the post-pandemic peak.
- Following exceptional apartment sector rent growth in 2021 and 2022, on-time payments began falling in the Spring of 2023 — from a high of 88.3% to a low of 85.2% in September 2024. However, while on-time collection performance has deteriorated in the past year, the October data offer a hopeful sign that the worst has passed.
- Of the three tracked property sub-types, properties with 2-4 rental units had the highest on-time payment rate in October 2024, coming in at 85.7%. Single-family rental (SFR) followed next with an on-time payment rate of 85.6%. Meanwhile, average on-time payment rates in multifamily properties sat slightly lower at 85.1%.
- Measured by State, western-located properties continue to outperform the rest of the country. On-time payment rates stand highest in October 2024 in Nevada (94.5%) — followed by Utah (94.1%), Idaho (92.5%), Colorado (92.2%) and California (91.7%).

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9. FOREIGN-BORN HOUSEHOLDS MAKE UP ONE-FIFTH OF US RENTAL DEMAND

- According to a recent Chandan Economics analysis of Census Bureau data, out of the 36.3 million rental households in the US, 9.4 million have a head of household born outside the country — accounting for 21.0% of total rental demand.
- Foreign-born US households are roughly 30% more likely to be renters than their US-born neighbors. With US population growth projected to sink lower in the coming decades — due in part to a falling birth rate — the dependence on foreign-born rental demand could continue to accelerate in the years to come.
- Over the past two decades, the foreign-born share of US rentals has gradually grown, from 17.8% of rental households at the turn of the century to a peak of 21.1% in 2016. Between 2017 and 2020, the share declined to 20.0% before climbing again in 2021 and 2022, reaching its previous high.
- Between 2000 and 2022, the number of foreign-born rental households in the US has grown by 47.6% — more than double the growth for US-born rental households (+20.5%) over the same period.

10. HIGHER INFLATION FOR LOW-INCOME HOUSEHOLDS

- A recent analysis by the Federal Reserve of Minnesota dives into mounting research showing diverging inflation patterns for lower vs higher-income households experienced both before and after the pandemic.
- Their modeling finds that since 2005, prices have risen 64% on average, for the lowest-income households, while the highest-income households have seen prices in their basket increase 57%.
- Zeroing in on the post-pandemic inflationary period, the poorest households have seen prices rise about two percentage points more than the richest ones—or about 8.3% faster than the average consumer price index (CPI) over this period.
- While these margins appear small in absolute terms, the differences are amplified when considering several underlying factors that affect poorer households, including the varying ability of households to substitute their purchases and how modest changes in purchasing power compound changes in income over time.

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SUMMARY OF SOURCES

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