Economic Update

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1. FED INTEREST RATE CUT

- The Federal Reserve cut its primary policy interest rate by 50 basis points (bps) in September to a target range of 4.75%-5%, the first interest rate reduction since policymakers began their fight against post-pandemic inflation in March 2022.
- Leading up to the September meeting, Fed Fund futures signaled that an overwhelming majority of market participants anticipated a rate cut. However, there was much speculation surrounding the magnitude of the reduction, with markets ebbing back and forth between forecasting a 25 bp and 50 bp cut.
- The rate cut signals that the FOMC believes that it has largely gotten inflation under control. At his post-meeting press conference, Fed Chair Jerome Powell stated that the large rate cut was a “recalibration” of central bank policy but did not imply an urgency to loosen borrowing conditions.
- Powell does not see an elevated risk of a US recession at this point in time. As he states, the economy is in “good shape,” and “inflation is coming down.” However, he affirmed that policymakers are prepared to adjust policy accordingly if necessary.
- As of September 25th, Federal Funds Rate futures markets forecast a second 50-basis point cut at the FOMC’s November meeting, followed by a 25-basis point cut in December.

2. JP MORGAN TALKS RATE CUT IMPACT

- A recent analysis by JP Morgan highlights potential refinancing and portfolio expansion opportunities for Commercial Real Estate, especially Multifamily, in the upcoming interest rate environment.
- The most obvious and immediate impact of rate cuts is a boost of liquidity in the financial system. As the report notes, CRE lenders have had to take larger than usual number of reserves against their portfolios to make up for compressed cash flow coverage that was a result of the interest rate hikes.
- As rates decline, cash flow coverage will increase, allowing lenders to inject reserves back into the market and facilitate more deal flow.
- JP Morgan singles out Multifamily as primed for opportunity in the new environment. Falling rates provide operators the chance to refinance at lower rates, which can —in turn — free up capital for renovations or new purchases.

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- Growth in valuations has also either slowed or turned negative in some markets, especially in large markets where the cost of living has risen, and there are typically larger pools of renters. These price points, combined with the demand outlook, provide investors an opportunity to expand into new markets or add new asset classes to their portfolios.

3. COMMERCIAL PROPERTY PRICES

- Commercial property prices finally climbed back into annual growth in August as the prospect of the eventual rate cuts boosted optimism and activity in the industry.
- According to the latest data from MSCI Real Capital Analytics, national commercial property prices rose 0.6% month-over-month in August, the fourth straight month of improvement. Prices are up 0.2% from one year ago.
- Each major sector of CRE experienced a month-over-price increase. Apartment prices rose 0.1% over the month, its first monthly increase since July 2022. Apartment prices are still down 5.7% in the past year and 18.9% from the 2022 peak.
- Office prices rose 0.2% during the month, with suburban offices continuing to outshine their urban alternatives. Suburban Office is up 0.5% month-over-month, though still down 4.7% year-over-year. Comparatively, CBD Office continues to post the most severe price declines of any sector, down 1.5% from July and 27.4% from one year ago. Nonetheless, both office segments have recovered from their peak declines of around 13% and 35%, respectively, seen at the end of 2023.
- Industrial continues to lead all other sectors in price growth, rising 0.4% from July and 6.9% in the past 12 months.
- The Retail index was up 0.3% from July and 0.1% annually.

4. ECONOMIC PROJECTIONS

- Released alongside their latest interest rate decision, the FOMC's September economic projections forecast 100 basis points of easing by the end of the year (which includes their initial 50 bp cut). The projections would suggest two more 25-basis point rate cuts in 2024. However, futures markets currently forecast a 50 bp cut in November, followed by a 25 bp cut in December.

- For 2025, policymakers expect an additional 100 bps in cuts, followed by 50 bp in cuts in 2026 before settling.
- Policymakers also lowered their inflation expectations. The forecast for PCE inflation in 2024 was lowered from 2.6% in the June projections to 2.3% as of September. PCE inflation is expected to fall to 2.1% in 2025, below the 2.3% forecast at the June meeting.
- GDP growth for 2025 was also revised lower, albeit slightly, from 2.1% at the June meeting to 2.0% in the latest projections.
- Unemployment projections were significantly revised upward, with the 2024 projections moving from 4.0% in June to 4.4% in September.

5. ECONOMISTS TALK RATE CUT IMPACT

- A recent analysis by Moody's CRE Economics suggests over the coming years, CRE demand is expected to hold steady as household formation numbers rise and incomes and employment growth are still projected to continue, despite recent labor market turbulence
- Traditionally, lower rates alongside higher cap rate yields encourage commercial real estate transactions and price discovery and reward borrowers with a lower loan interest payment.
- Still, as Moody's notes, most of the expected future rate cuts have been baked into treasury prices, and the CRE industry has already been adjusting to the expectation of higher long-term interest rates even as things are normalized. The Fed is expected to settle at a Federal Funds rate of around 3% by the end of 2026.
- Economists are also cautious about how rate cuts could eventually impact the prices of building materials. Building materials are mostly imported goods that domestic construction markets rely on to meet demand. As interest rates fall, the US dollar will weaken, making foreign goods more expensive to American consumers.

6. CONSUMER CONFIDENCE FALLS

- According to the latest data from the Conference Board, consumer confidence fell in September after reaching a six-month high in August.
- The index declined to 98.7, which was below expectations. Both the present situation index, which measures current business and labor market conditions, and the expectations index, which looks at consumers' short-term outlook, fell during the month.
- Notably, the expectation index, which fell to 81.7, notched closer to "recession territory." Historically, an index value below 80 signals a recession within the next 12 months.
- The report suggests that despite some bullish sentiment in the business community in reaction to interest rate cuts, consumers' concerns about the labor market and prices remain front of mind. The coming months will better reveal how the ongoing loosening of financial conditions factors into consumer sentiment.

7. OPEN AI PITCHES WHITE HOUSE ON DATA CENTERS

- Open AI CEO Sam Altman reportedly recently pitched the Biden Administration on the need for a US investment in large data centers, which the company sees as integral for America to compete with China and other global competitors in the AI race.
- The suggestion comes amid the backdrop of an AI race that has become increasingly framed in strategic geopolitical terms. Meanwhile, the real estate industry has become a critical component of AI infrastructure, with Data Centers becoming one of the largest growth segments of CRE in recent years.
- Open AI believes that for US companies to keep pace with global competitors such as China, the country would need to build data centers that utilize the power of entire cities.
- Altman says that investing in these facilities would also create thousands of jobs and boost GDP while aligning with the US' long-term strategic goals.

8. INDEPENDENT LANDLORD RENTAL PERFORMANCE

- On-time rental payments in units operated by independent landlords slid for the fourth consecutive month in September 2024, according to the latest data from Chandan Economics

- An estimated 84.9% of tenants in independently operating rental units completed their monthly payments on time. The on-time payment rate is down by 19 bps from the month prior, 148 bps from the same time last year, and 334 bps from the post-pandemic peak —reflecting a gradual and consistent deterioration in collection performance.
- Despite the decline in on-time payment rates, there are signs of stabilization. September's forecast full-payment rate, which includes on-time payments, late payments, and expected late payments based on historical trends, came in at 94.5% — an improvement of 21 bps from August. Nevertheless, full collection rates are down by 275 bps from their post-COVID high (97.2%).
- Of the three tracked property sub-types, single-family rental (SFR) and properties with 2-4 rental units came in neck-and-neck in September at 85.1%. Meanwhile, average on-time payment rates in multifamily properties sat slightly lower at 84.5%.

9. RETAIL SALES

- According to advanced estimates from the US Census, US retail and food services sales rose by 0.1% month over month in August and 2.1% over the past 12 months.
- Measuring seasonal performance, total sales between June and August were up 2.3% from the same period in 2023, an impressive clip considering that consumers, on average, encountered tighter financial conditions compared to one year prior.
- Sales for non-store retailers are up 7.8% compared to one year ago, while food services and drinking places are up 2.7% year-over-year.

10. HOME PRICES AND SALES

- The NAHB Housing Market Index rose to 41 in September, breaking four consecutive months of declines in activity, according to the latest findings by the National Association of Home Builders (NAHB).
- The index for current sales conditions rose by one point, while sales expectations in the next six months rose by four points. The index measuring the traffic of prospective buyers also posted a gain compared to last month.
- The share of builders cutting prices to meet demand dropped in September for the first time since April.

- Overall, turnaround is a welcome signal for the construction market as it gears up for an expected uptick in activity following the Fed's interest rate pivot. However, as the dollar weakens and imports become more expensive, operators will need to consider how this may affect homebuilder costs as construction demand picks up.

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SUMMARY OF SOURCES

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