AEW RESEARCH

U.S. Economic & Property Market Perspective

Q4 2023

AEW

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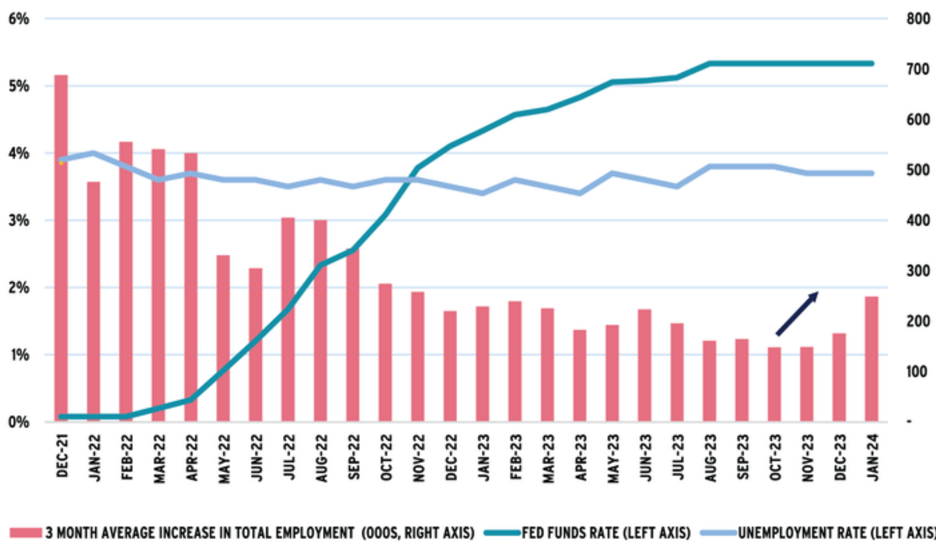
U.S. Economic and Property Market Outlook

The U.S. economy continues to surprise to the upside, posting annualized fourth-quarter real GDP growth of 3.3% (3.1% year over year) on top of the nearly 5% annualized growth in the third quarter. Similarly, U.S. job growth has accelerated in each of the past three months after nearly two years of steadily moderating gains in response to steadily rising interest rates. Perhaps most significantly, the U.S. unemployment rate has remained low and stable, hovering between 3.4% and 3.8% since January 2022.

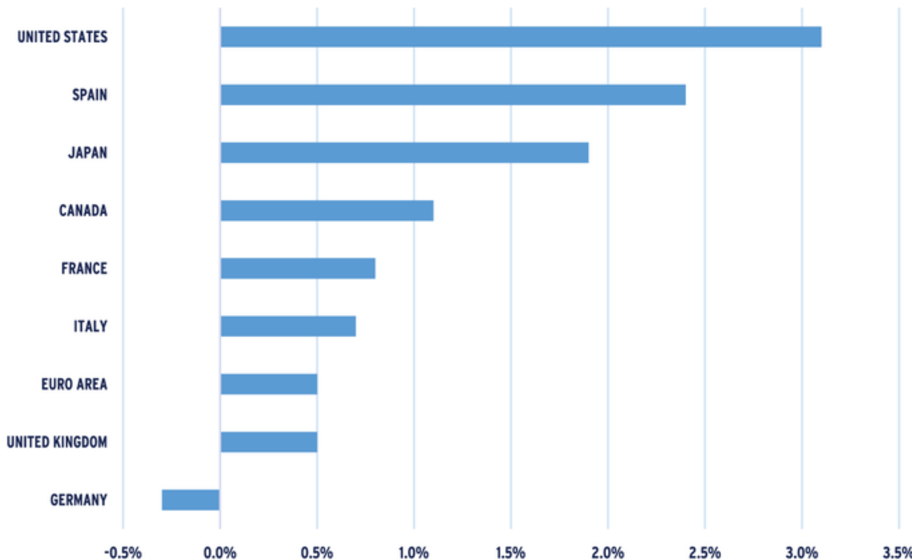
FIGURE 1: PRIVATE SECTOR JOB GROWTH OVER PRIOR THREE MONTHS, THE UNEMPLOYMENT RATE AND FED FUNDS RATE



Source: Bureau of Labor Statistics (BLS), Federal Reserve

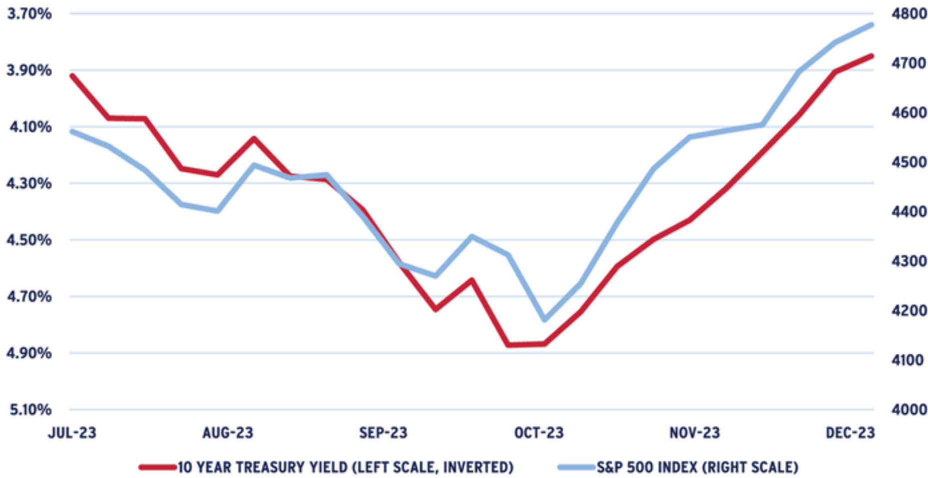
While strong on an absolute basis, U.S. growth appears even stronger relative to other advanced economies. In their most recent assessment of the global economy, the International Monetary Fund, noted the U.S. advantage relative to Europe and Japan, citing more rapid and extensive U.S. fiscal and monetary policy response to pandemic dislocations with their current forecast projecting slower but continued near-term U.S. economic outperformance.

FIGURE 2: 2023 REAL GDP GROWTH



Source: International Monetary Fund (IMF) estimates, World Economic Outlook Update – January 2024

FIGURE 3: EQUITY AND FIXED INCOME Q4 RALLY

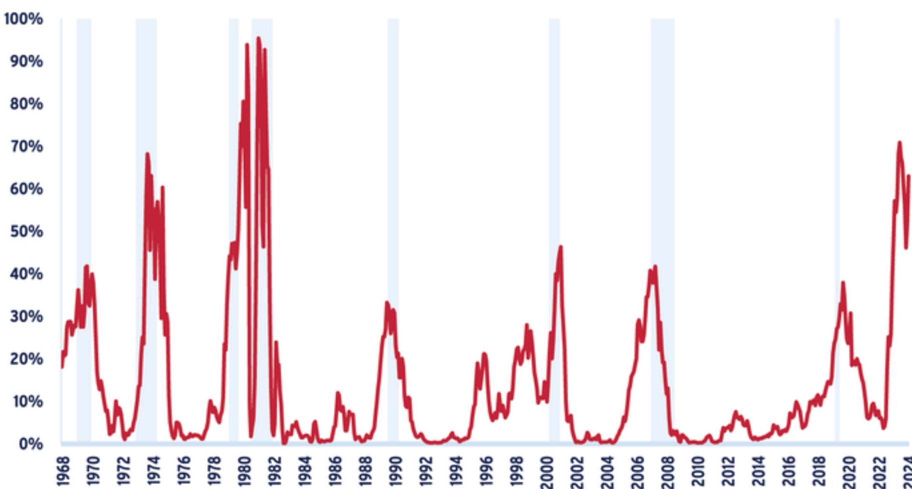


Source: Moody's Analytics, Federal Reserve

Reflective of this stronger growth and, perhaps more importantly, in anticipation of monetary policy easing during 2024 (and beyond), equity and fixed income markets rose sharply during the fourth quarter with stock indexes reaching new highs and the benchmark 10-year Treasury bond yield falling by nearly 100 basis points. Not surprisingly, buoyed by continued low unemployment and rising asset market values, U.S. consumer sentiment improved significantly during the last two months of 2023, sparking one of the largest quarterly increases in decades across the various confidence indices.

For its part, the Federal Reserve has, over the past six months, held its overnight lending rate target steady between 5.25% and 5.50% and at the January meeting of the Federal Open Market Committee (FOMC), strongly signaled that any lowering of the target rate will remain on hold at least until May of this year. Obviously, if U.S. economic growth continues to outperform expectations, the Fed's urgency to begin lowering interest rates would wane. Similarly, any rapid deterioration in the broader economic environment would likely accelerate Fed easing. To this point, we continue to acknowledge that numerous historically prescient indicators of potential recession continue to flash warning signals. For example, the New York Fed's recession probability index (Figure 4), while improved over the past several months, still suggests more than a 60% probability of recession by the end of 2024.

FIGURE 4: FEDERAL RESERVE BANK OF NEW YORK RECESSION PROBABILITY INDEX

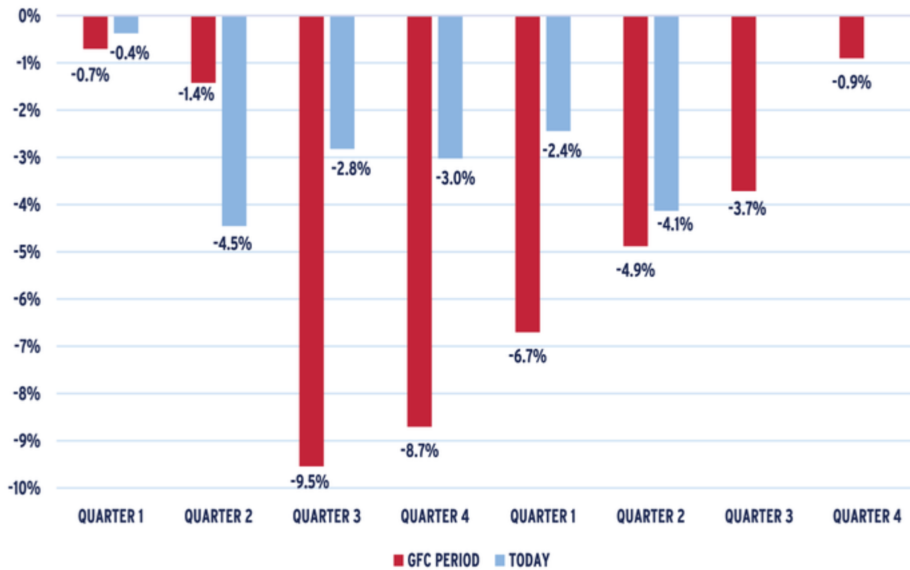


Source: Federal Reserve Bank of New York

U.S. Commercial Property

In contrast to the U.S. equity and fixed income markets, U.S. commercial property values, as measured by the NCREIF Property Index (NPI), declined 4.1% during the fourth quarter, marking the sixth consecutive quarterly decline and a peak-to-trough decline of slightly more 16.1% (so far). For comparison, property capital values declined for eight consecutive quarters during the global financial crisis (GFC) period for a peak-to-trough unleveraged decline of approximately 32%.

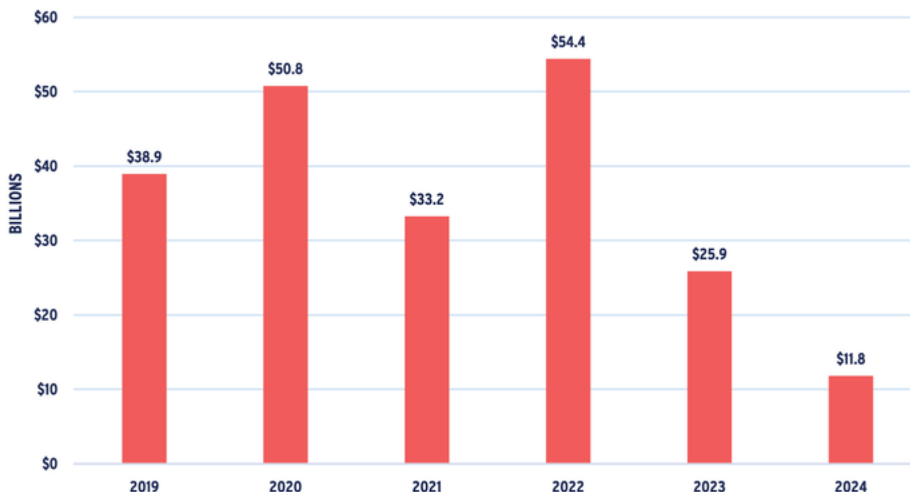
FIGURE 5: QUARTERLY CHANGE IN CAPITAL VALUE INDEX



Source: NCREIF , as of Q4 2023

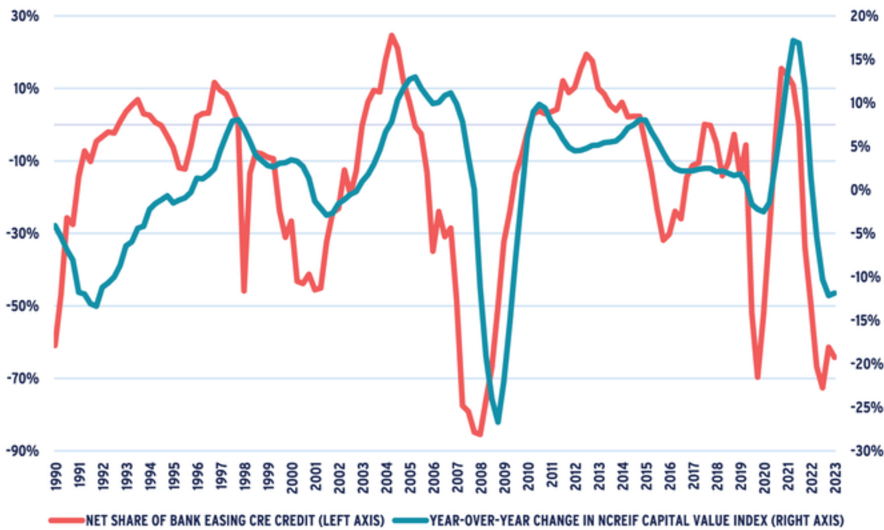
Commercial property transaction activity remains limited with 2023 total volume ($370 billion) falling to the lowest level since 2013. While one month does not make a trend, total transaction activity in January 2024 totaled roughly one-half January 2023 and one-fifth January 2022 (Figure 6). The greatest property market tension point remains debt maturities, especially for properties with uncertain near-term cash flow, particularly many office properties. While all property lenders are exercising greater caution in the current environment, banks, especially regional and smaller banks, remain the most constrained. Data from the Federal Reserve's quarterly survey of senior loan officers suggests bank lending to commercial property is nearly as constrained today as it was during the GFC (Figure 7). As shown, commercial property values have historically trailed bank commercial property credit conditions by roughly four quarters with values declining as credit conditions tighten.

FIGURE 6: JANUARY U.S. COMMERCIAL PROPERTY TRANSACTION VOLUME BY YEAR



Source: RCA/MSCI

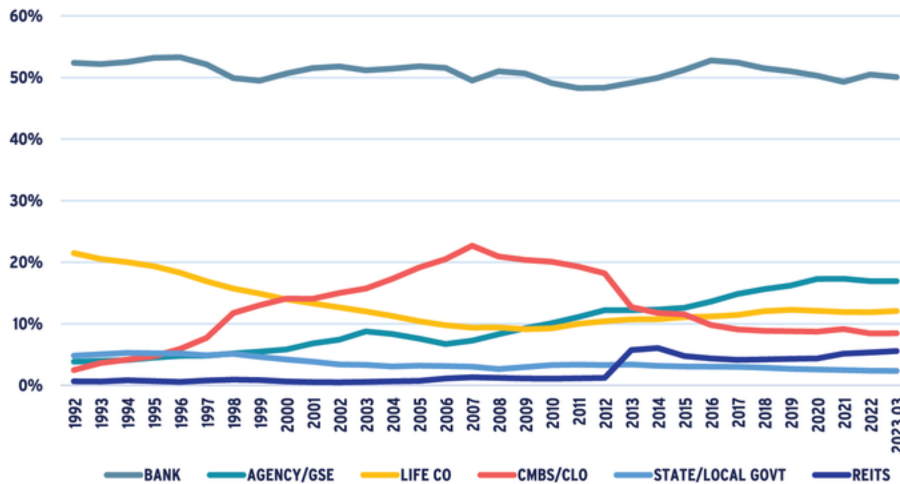
FIGURE 7: U.S. BANKS WILLINGNESS TO LEND TO COMMERCIAL REAL ESTATE



Source: Piper Sandler, Federal Reserve, NCREIF

We expect commercial property credit constraints related to banks will persist through 2024 and likely beyond. Outstanding commercial and multifamily property loans in the U.S. total more than $5.8 trillion and approximately $1.5 trillion of this will mature over the 2024-2026 period. Banks in aggregate represent roughly half of this total and regional (and smaller) banks have steadily increased market share within the bank category over the past decade. As problem property loans, particularly office properties, continue to surface in various bank balance sheets, regulatory and shareholder pressure on banks to reduce their exposure to commercial property will likely continue for several years.

FIGURE 8: SHARE OF COMMERCIAL & MULTIFAMILY MORTGAGE MARKET

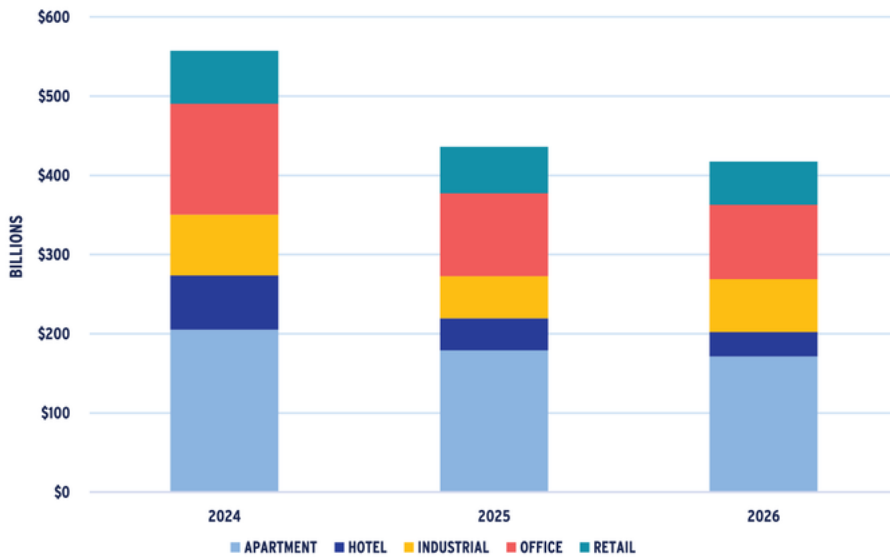


Source: Piper Sandler, Federal Reserve, NCREIF

Against this backdrop of more constrained lending, property loans will continue to mature on pace with past transaction volumes and financing. During 2024, we expect more than $500 billion of loan maturity with comparable, albeit somewhat smaller, pacing for 2025 and 2026, reflecting lower transaction volume in 2020. Generally, lenders are likely to size refinancing of maturing loans to more conservative metrics (e.g., loan to value, debt service coverage). At the same time, property values will likely have changed since the time of the original loan. We believe the loans that will prove most difficult to refinance with loan proceeds sufficient to extinguish the original loan balance will be those situations where more stringent lending metrics (e.g., lower loan to value ratios) are being applied to properties with lower values. In these cases, there will be a gap between existing loan balances and new loan proceeds (i.e., a debt funding gap). Currently, we estimate the aggregate

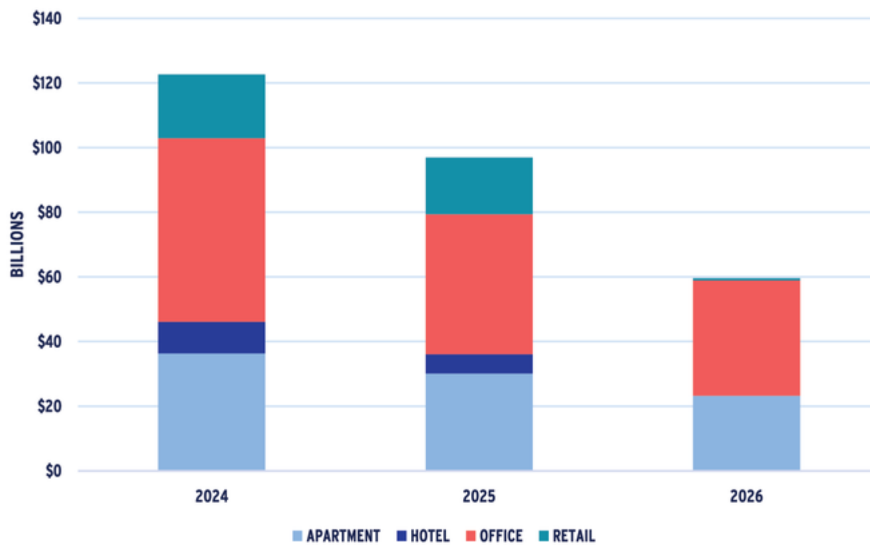
potential funding gap for 2024 to be more than $100 billion (Figure 10), with somewhat smaller funding gaps during 2025 and 2026.

FIGURE 9: EXPECTED COMMERCIAL MORTGAGE LOAN MATURITY BY YEAR



Source: RCA/MSCI, AEW Research

FIGURE 10: EXPECTED DEBT FUNDING GAP BY YEAR



Source: AEW Research

Conclusion

The U.S. economy continues to perform above expectations, growing faster than nearly all forecasts and certainly above growth rates of comparable advanced economies. This growth is especially remarkable as it has occurred during a period of rapid and significant tightening of credit conditions by the Federal Reserve. The Fed has given clear indications that it believes it is winning its battle with outsized inflation and should be approaching a period of loosening credit and lowering interest rates by mid-year, but stronger (or weaker) economic activity could easily delay (or accelerate) any Fed action.

Continued economic resilience and lower borrowing costs would undoubtedly be positive for property investors, and investors in other asset markets have already begun to embrace this prospect. Property markets do, however, react more

slowly and we expect the current period of valuation adjustment to continue, most likely through at least mid-year, but possibly longer if the Q4 enthusiasm in the public markets were to wane.

Office

The momentum in office fundamentals remained persistently negative through the end of the year. Vacancies climbed 20 basis points (bps) to 18.6% in the fourth quarter, continuing the pattern of rising rates according to CBRE-EA. Sublease space accounted for 250 bps of overall vacancy with availability rates inching down slightly to just below 25%. San Francisco sits at the top of the list as the most challenged market in the country with a vacancy rate approaching 25%; Salt Lake City, Houston, Dallas, and Portland round out the top five. Eighteen metros had rates above 20% in the fourth quarter with only three notching improvements over the quarter. The Florida markets continue to outperform, most notably Southeast Florida and Orlando, with Boston and San Diego also outperforming at vacancies below 15%. In aggregate, negative demand accounted for most of the vacancy rise in 2023 with net absorption falling by 30 million square feet (msf) nationally according to CBRE-EA. Most of the decline occurred through the first half of the year before moderating to -2.9 msf in the fourth quarter. Completions were a contributing factor but the pipeline of projects under construction is low relative to historical standards at ~70 msf. New supply is more pronounced in select markets like Austin, Boston, Dallas and Seattle, but the current financing environment makes it difficult to initiate new projects.

Understandably, investor sentiment for office is still solidly in the pessimistic camp. Lenders and equity providers maintain their defensive stance as they look to reduce overall exposure in the face of an already difficult capital markets environment. The sector faces some of the stiffest headwinds regarding future values with acceptance of the hybrid work model becoming entrenched in employee and employer expectations. Multiple indicators such as key card swipes, transportation statistics, mobility indicators and surveys suggest physical office attendance has stabilized over the past year. Companies have been adjusting to the new reality with consolidations and space reductions becoming the pervasive theme. Leasing activity (new and renewals) remained sluggish in the fourth quarter, running about 62% of the pre-COVID pace. Looking ahead, these dynamics are likely to continue.

Contractual lease structures will play a role in the pace at which companies will be able to right size their space requirements. Costar's estimates approximately 55% of leases signed prior to 2020 (in terms of square footage) have expired, which has allowed these companies to adjust their space needs accordingly. The impact has been clear in terms of negative absorption and rising vacancy rates. Another 15% of pre-pandemic leases are expected to roll over in the next two years. For companies with longer leases expiring after 2026, the sublease market has been a viable alternative for potentially reducing space requirements. That dynamic appears to be waning with the amount of space on the sublease market plateauing in the second half of 2023. All told, AEW Research anticipates vacancies will likely move higher in 2024 with the increase coming from direct vacancies before peaking in 2025. An encouraging sign potentially cushioning the pace of space reductions has been an economy that continues to expand above expectations adding to the job base. That said, it remains to be seen how the economy holds up in 2024.

FIGURE 11: OFFICE TRANSACTION VOLUME AND PRICING TRADES $20 MILLION AND ABOVE

Source: MSCI/RCA through Q4 2023

The impact on values is playing out much quicker in the public markets, while the private equity market has been much slower to adjust. Limited transaction volume, wide bid-ask spreads and lack of debt financing has muddied the water on pricing. Current estimates of office value loss on the private side relative to previous peaks range as high as 40% with additional risk to the downside being noted. Through Q4 2023, the NCREIF capital appreciation index reflected an aggregate decline of 29% from previous highs with the third quarter accounting for 500 bps of the decline. That said, at the asset level the range can be much wider.

Distress is becoming more apparent as banks and other lenders increase loan-loss reserves and the CMBS market is reporting a notable increase in the percentage of office loans in special servicing and delinquency. Correspondingly, financing remains scarce and prohibitively expensive, sending the signal that the ability of owners to extend terms until a brighter future will be more challenging this cycle than last. Anecdotally, more lenders are allocating resources towards workout teams, especially at banks where the focus is more squarely on office CRE. To that end, select transactions have taken place memorializing the level of losses on some of the most stressed assets that often include a degree of debt impairment. For the most part, banks are better capitalized today than they were prior to the GFC providing more leeway and a willingness to recognize losses.

Overall, the office dynamics remain challenging with few indications of a brighter 2024 than what we saw in 2023. In fact, we anticipate a higher degree of recognition and realization in values losses in 2024 with lenders less willing to provide additional time to owners lacking a tangible path forward. Owners, investors, and lenders are facing increasingly difficult decisions about what to do as loans (or extended loans) mature or as major leases come due. Each case requires material new capital contributions from ownership or in some cases the lender to forge an appropriate path forward. Based on our research, AEW believes 2024 is setting up to be a year where paper losses will translate more into realized losses for office.

OFFICE	
VACANCY RATE	18.6%
12-MONTH HISTORICAL TREND	
VACANCY CHANGE	↑
RENT	↓
ABSORPTION	↓
COMPLETIONS	↓
CAP RATES	↑
TRANSACTION VOLUME	↓

Apartment

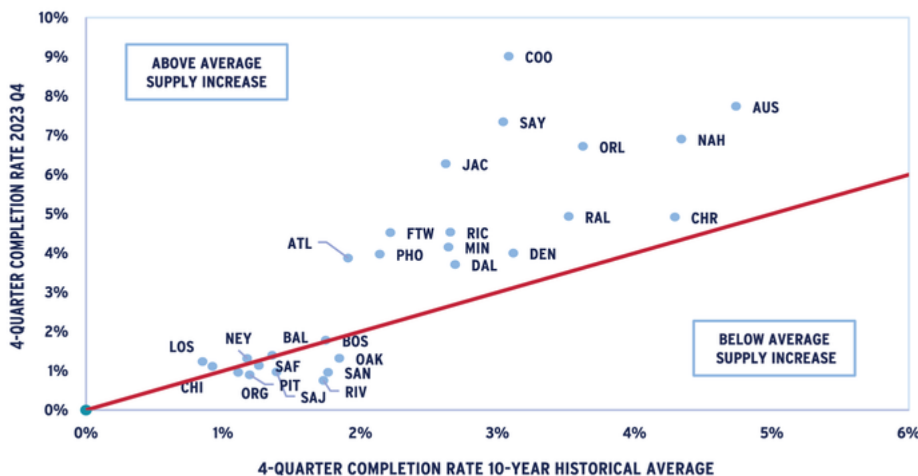
As expected, given the unprecedented levels of supply being completed, apartment market fundamentals continued to sway in favor of tenants to close out 2023. Nationally, vacancies increased to 5.4% in 2023 Q4, up 20 basis points (bps) from the previous quarter and 80 bps from the prior year. This marks the seventh consecutive quarterly increase in vacancies. Putting the market in further context, vacancies are now 300 bps above their COVID low, nearly 100 bps above their 10-year historical average and 120 bps above the 5-year historical average.

Importantly, demand trended higher in the second half of the year with nearly 170,000 units being absorbed on net, the greatest 6-month demand total since the first quarter of 2022 and ahead of the 5- and 10-year historical 6-month moving average demand. Moreover, despite a weak first quarter, the four-quarter moving average net absorption (252,000 units) was in line with the 10-year historical average and only 7% below the 5-year average.

While the demand picture is showing notable improvement, the benefits of this stronger demand have been more than outweighed by historic levels of new supply coming online. Nearly 141,000 units were completed in the fourth quarter, a record high and roughly double the quarterly deliveries historically. Fourth-quarter completions topped the previous record-setting deliveries of roughly 118,000 units in the third quarter. Overall, roughly 416,000 units were completed over the year, 37% and 55% above the 5- and 10-year 4-quarter moving average, respectively.

We believe supply growth will remain elevated through 2024 with nearly 553,000 units currently under construction projected to be delivered this year. Beyond 2024, supply growth should slow meaningfully with 195,000 units currently underway and declining multifamily permitting activity. Multifamily permitting (5+ units) peaked in December 2001 and is roughly 40% off peak and trending lower.

FIGURE 12: SUNBELT SUPPLY GROWTH IS OUTPACING HISTORICAL AVERAGES (SELECT MARKETS)



Source: U.S. Census Bureau, as of Q4 2023

Regionally, among the 69 markets tracked by CBRE-EA, vacancies ranged from a high of 8.8% in Corpus Christi to a low of 2.8% in Madison, Wisconsin. Of note, 17 of the 18 markets with vacancies of 7% or higher were in the Sunbelt; only Honolulu (7.6%) fell outside of this geography. On the other end of the spectrum, only three of the 21 markets with vacancies of 5% or lower are in the Sunbelt (Norfolk, 4.8%; Lexington, 4.5%; and Miami, 4.7%). Instead, the bulk of markets with the lowest vacancies are coastal/gateway markets or their smaller neighbors (New York, Providence, Orange County, Newark, Hartford, Milwaukee, Ventura, Long Island, San Diego, Boston, Philadelphia, San Jose, Los Angeles, San Francisco and Chicago). A similar picture emerges when looking at the change in vacancies since the COVID trough and current vacancies relative to the 10-year historical average, the Sunbelt markets are notably weaker relative to the coastal markets.

Not surprisingly, the run up in vacancies in the Sunbelt has been driven largely by new supply. Again, Sunbelt markets dominated the top 15 markets with the highest completion rates. Colorado Springs, Austin, Salt Lake City, Nashville, Orlando

and Jacksonville led the way with 4-quarter completion rates over 6%, ranging from 9.0% to 6.3%. Raleigh, Charlotte, Richmond, Fort Worth, Denver, Phoenix, Atlanta and San Antonio followed with completion rates between 4.9% and 3.8%. Minneapolis was the only non-Sunbelt market within the top 15 markets, with a completion rate of 4.2%. On average, the current completion rate in the aforementioned markets was 234 bps above their 10-year historical averages but the most significant differences were in Colorado Springs, Salt Lake City, Jacksonville, Orlando and Austin where supply growth was 300+ bps above their historical average. In contrast, supply growth in Denver, Charlotte and San Antonio was more in line with historical averages, exceeding historical trends by only 89, 63 and 8 bps, respectively. Markets with the lowest supply growth included many of the markets with the lowest vacancies (i.e. coastal gateway markets) as well as several secondary/tertiary and Midwestern markets. Roughly 32 markets reported a completions rate of 2.0% or less. Completions in San Jose, Portland, Pittsburgh, Long Island, Orange County, San Francisco, Boston, Baltimore, New York, Chicago and Washington, DC, in particular, were below or essentially on par with historical averages.

While supply growth was robust in many Sunbelt markets, demand was strong and led demand growth among markets; however, demand was simply outpaced by new supply. This supply overhang will eventually erode, however, as there are significant demographic tailwinds that should prompt healthy demand in the coming years. Indeed, roughly 45% of people aged 18 to 29 are currently living at home, according to a recent survey by Harris Poll/Bloomberg. This amounts to 23 million people who will eventually move out and form their own households. Financial considerations were the main reason for these young people residing at home; thus, once they eventually establish their own households, it can be assumed that some of these young adults will be lured to lower-cost areas in the Sunbelt. Moreover, many young people will remain "priced out" of the for-sale housing market. Despite the substantial increase in mortgage rates, a lack of homes for sale is working to keep home prices elevated. The combination of higher mortgage rates and still-high home prices has prompted a decline of more than 40% in affordability since the end of 2019. Given the combined impact of strong expected demand among young people and a lack of affordability on the for-sale side, we fully expect the apartment market to recover in 2025 and beyond and the recovery in the Sunbelt markets to be particularly strong.

RESIDENTIAL

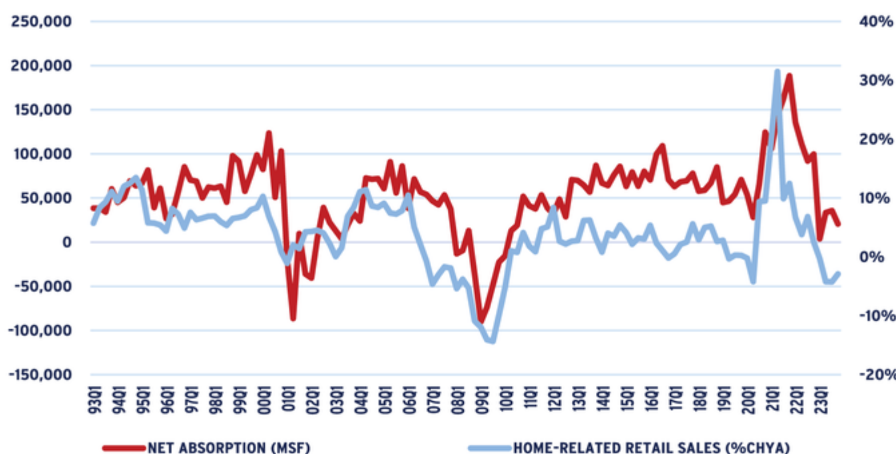
VACANCY RATE	5.4%
12-MONTH HISTORICAL TREND	
VACANCY CHANGE	↑
RENT	↓
ABSORPTION	↑
COMPLETIONS	↑
CAP RATES	↑
TRANSACTION VOLUME	↓

Industrial

The industrial sector has softened, and availability is at its highest point since early 2021, increasing to 7.1% in the fourth quarter of 2023. Availability was up 60 basis points (bps) quarter-over-quarter and 230 bps year-over-year. Availability is now above the 5-year historical average and only 20 bps below the 10-year historical average.

Demand was exceptionally muted in 2023 with only 20 million square feet (msf) absorbed in the fourth quarter and less than 100 msf for the year in total. 2023 had the lowest level of absorption reported on an annual basis since 2010. Weaker home sales were partially to blame for the weakened demand as sales of furniture, building materials and appliances softened. Demand weakness was more pronounced in leases of 1 msf or larger in 2023. Per CoStar, only 45 leases of 1.0 msf or larger were signed in 2023, totaling 54.6 msf, roughly half the 104.8 msf of leases signed in 86 deals in 2022. In 2022, Lowe's and Home Depot alone combined for 13.1 msf in signed leases over 1.0 msf; in 2023, neither home improvement store signed a lease in excess of 1.0 msf. Target, Wal-Mart and Wayfair also signed fewer leases in 2023, totaling only 2.6 msf compared to over 10 msf in 2022. In contrast, Amazon's large leases increased modestly to 8.7 msf in 2023 versus 8.0 msf in 2022. The bottom line with regard to demand is that tenants took a more cautious stance in 2023, preparing for a potential economic downturn.

FIGURE 13: SLOWER CHURN AND ASSOCIATED RETAIL SALES RESULTED IN MODERATING DEMAND



Source: National Association of Realtors (NAR), as of January 2024

The slowdown in demand has been broad based with all but 12 markets reporting a lower absorption rate in 2023 versus 2022. The only major markets where demand held steady or was slightly improved were Boston, Fort Lauderdale, Cleveland, Los Angeles, West Palm Beach and Las Vegas. Of note, a number of secondary/tertiary markets also reported steady demand, including Oklahoma City, Greenville, Westchester, Toledo, Tulsa and El Paso. The greatest softening was in Manhattan, Allentown, Indianapolis, Charleston, Salt Lake City, Vallejo, Tucson, Memphis, San Francisco, Minneapolis, Fort Worth and Stockton, where the absorption rate was 300 bps or more below the year-ago level. Relative to historical averages, Raleigh, Minneapolis, Houston, Cleveland, Nashville, Austin, Savannah and El Paso continue to have absorption rates above their 10-year averages (4-quarter moving average). The number of markets where current demand exceeds historical trends narrows to only eight secondary/tertiary markets when comparing to the 5-year averages; the growing Greenville, Nashville and El Paso markets are among those eight. Weakness is generally concentrated in big box and gateway markets with Allentown, Indianapolis, Riverside, San Diego, Atlanta, Seattle, Central NJ, Northern NJ, Columbus and South Central PA showing notable slowdowns versus their historical averages.

On the supply side, construction activity remained robust with nearly 130 msf being completed nationally in 2023 Q4, down only slightly from the record completions of 137 msf reported in the previous quarter. On an annual basis, roughly 487 msf was delivered in 2023, a record-breaking year, outpacing the 10-year historical average by more than 200 msf. The acceleration in supply in 2023 was broad based with nearly all markets posting a higher completion rate in 2023 Q4 relative to

both one year ago and their historical averages. The uptick in supply has been particularly strong in Savannah, Greenville, Austin, El Paso, Phoenix, Charleston and Las Vegas where the 2023 Q4 completion rate was well above historical averages.

Not surprisingly, given the increase in supply and moderating demand, availability surged in Savannah, Greenville, El Paso, Fort Worth and Las Vegas. Availability in these markets increased between 10.1 percentage points and 260 bps over the course of the year. In Savannah, availability now stands at 10.6%, one of only four markets with double-digit availability. Of note, however, is that roughly half the availability in Savannah is in 10 buildings. Availability has likely not reached its peak yet, however, as supply is expected to remain robust through 2024 with roughly 380 msf underway nationally. Austin (13.9% of inventory), Las Vegas (11.2%), Savannah (10.0%), Phoenix (9.8%) and Charleston (8.8%) lead the way in terms of supply currently underway.

Going forward, deglobalization resulting from pandemic shortages and disruptions in shipping routes is spurring continued onshoring/near-shoring of manufacturing. Increased domestic production will create new sources of domestic demand for logistics as well as some amount of new higher-wage jobs. So far, the amount of new manufacturing jobs has been limited as new production facilities are likely to be more highly automated than prior generations of production facilities. That said, there will be jobs created from suppliers and support services for these facilities, which will boost local property markets. Again, winners in this area are largely Sunbelt markets (Phoenix, Dallas, Atlanta, Savannah, Raleigh, Greensboro and Salt Lake City). On the margin, demand growth in global port locations will be slower and demand growth in regional distribution centers will be stronger. While growth in port markets may be slower, the importance of these markets in the broader logistics market remains. With respect to trade, Savannah's continued port infrastructure improvements should boost trade flows and increase the port's market share, which should result in strong demand and improving fundamentals. Finally, a lack of supply in Southern California and the resolution of labor contracts at the port should support continued tight market fundamentals. Additionally, even with more domestic sourcing of production, greater uncertainty around the global supply chain will lead many warehouse users to hold higher levels of inventory than pre-pandemic. Overall, we believe the outlook for the industrial market is decidedly positive post-2024.

INDUSTRIAL	
AVAILABILITY RATE	7.1%
12-MONTH HISTORICAL TREND	
AVAILABILITY CHANGE	↑
RENT	↑
ABSORPTION	↓
COMPLETIONS	↑
CAP RATES	↑
TRANSACTION VOLUME	↓

Retail

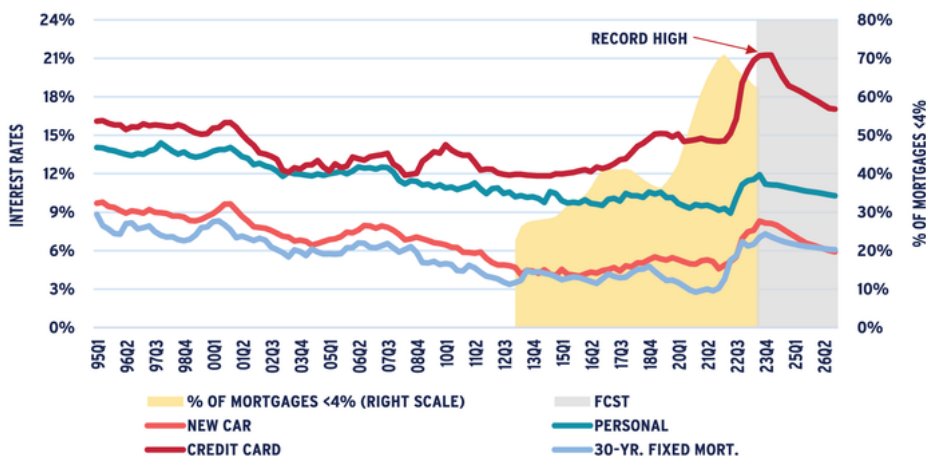
While office, industrial and apartment fundamentals continue to slip, the retail sector continues to improve with availability dropping to record lows. Total retail availability declined to 4.7%, down 10 basis points (bps) quarter-over-quarter (QOQ) and 20 bps year-over-year (YOY). Overall, retail availability has improved from a post-COVID high of 6.6% in late 2020 and is nearly half the record high of 9.9% post-GFC. Availability remained around 10% for much of 2010 and 2011. Further, total retail availability now sits 260 bps below the long-term quarterly average (2005-2023).

Unsurprisingly, the strength in the market remains concentrated in the neighborhood and community shopping centers (NCSC) and power centers (PC) while the lifestyle and Mall (L&M) sector remains slower to recover. Availability in the NCSC sector improved to a new record low of 6.5%, down 10 bps QOQ and 40 bps YOY. Further, availability has improved 280 bps from the post-COVID high, 660 bps from the GFC-high and is 340 bps below the long-term historical average. The PC segment of the market has reported similar performance with availability declining to 5.0% in 2023 Q4, down 30 bps QOQ and 20 bps YOY. However, the improvement from the post-COVID (-240 bps), post-GFC (-410 bps) and historical average (-140 bps) has been more muted relative to the NCSC segment of the market. Moreover, availability is 100 bps above the 2005 Q4 record low. Meanwhile, availability in the L&M segment of the market has improved more modestly and availability, at 5.6%, remains above the historical average of 5.1%. Overall, L&M availability has improved 40 bps QOQ, 30 bps YOY and only 90 bps from the COVID high.

The improvement across the retail market is entirely the result of a resurgence in demand as there has been no meaningful supply delivered to the market in nearly two decades. Indeed, supply increased by a mere 0.3% in 2023, the lowest level of new construction ever reported and well below the roughly 1.0% four-quarter completion rate reported through 2015-2016 and the more than 2.0% growth reported through much of the mid- to late 2000s. Demand, which was briefly negative during the pandemic and below 1.0% on a four-quarter moving average basis for the 2017-2019 period, picked up post pandemic, advancing to 1.5% in early 2022. Since then, demand has been steady but more modest; however, this is solely the result of a lack of available product.

The underpinning of the resurgence in demand has been a resilient consumer. Indeed, it appears the holiday shopping season bested expectations with total retail sales increasing 0.6% in December month-over-month and 5.6% year-over-year. December's YOY growth was the strongest since January 2023. Growth was driven by restaurants, electronics, appliance stores, drugstores, vehicle dealers and nonstore retailers, which off-set weaker sales at department stores and gasoline stations (result of falling fuel prices), and softer housing-related sales at furniture and building supply stores.

FIGURE 14: RETAIL SALES HEADWINDS: HIGHER INTEREST PAYMENTS AND LOWER HOUSING MARKET CHURN



Source: U.S. Board of Governors of the Federal Reserve System (FRB); Moody's Analytics Forecasted

This strength in sales was surprising and is unlikely to be sustainable, given headwinds facing the consumer. First, the resumption of student debt repayments will impact roughly 40 million Americans, approximately half of them under 30. This could have a notable impact on spending as the prime spending ages are generally between the late 20s and early 40s. It is estimated that the average monthly payment on student debt could take between $350-$400 per month out of individual discretionary spending, totaling nearly $18 billion per month. Moreover, financial distress among student borrowers has shown itself as nearly 40% did not make their October monthly payment by mid-November. Next, lower housing market churn will likely limit spending. With over 60% of mortgages locked in at rates 4% or lower, well below today's prevailing rate of over 7%, the willingness of homeowners to move has fallen substantially. Home sales dropped to 3.8 million units (seasonally adjusted annual rate) in December and 4.09 million units for the year, the lowest level in nearly 30 years. Further, pending home sales and limited inventory of homes for sale portend additional weakness in the near-term. The reduction in sales is significant for retail sales as it is estimated that each new home sale generates $5,000 in home-related retail sales. Finally, record levels of credit card debt, significantly higher interest rates and the resulting surge in interest payments should also work as a headwind to sales.

While retail sales are expected to slow, retail fundamentals should remain solid, again supported by a lack of available product in the market today and limited supply underway. Overall, the pendulum has swung in favor of landlords. Rent growth will likely accelerate; however, pushing overall rent rolls higher will take time as many leases are locked in long-term or have extensions with fixed rate increase that haven't kept up with market increases. Nevertheless, AEW believes some sectors of the market should outperform with more necessity-based retail and off-priced retail dominant centers expected to be stronger relative to the more discretionary apparel-based L&M sector.

RETAIL	N&C SHOPPING CENTER	LIFESTYLE & MALL	POWER CENTER
AVAILABILITY RATE	6.5%	5.6%	5.0%
12-MONTH HISTORICAL TREND			
AVAILABILITY CHANGE	↓	↓	↓
RENT	↑	↑	↑
ABSORPTION	↓	↔	↓
COMPLETIONS	↔	↔	↓
CAP RATES	↑	↑	↑
TRANSACTION VOLUME	↓	↓	↓