Economic Update

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1. Q1 2023 GDP

- The US economy grew at an annualized rate of 1.1% during the first quarter of this year, slowing significantly from the Q4 2022 annualized rate of 2.6% and registering well below the Dow Jones consensus forecast of 2.0%.
- Growth in Q1 primarily reflected an increase in consumer spending partially offset by a decrease in private inventory investment.
- The increase in consumer spending was aided by increases in both goods and services spending. Spending on motor vehicles and parts led to goods consumption, while an increase in health care and food services spending carried much of the rise in services.
- Government spending increased during Q1. On the federal level, the increase primarily reflected non-defense expenditures, while on the state and local level reflected a rise in compensation for government employees.
- A pullback in Wholesale Trade growth led to a decrease in private inventory investment, specifically within machinery, equipment, and supplies. Manufacturing also saw a retreat.
- A decline in residential fixed investment was led by a decrease in new single-family home construction.

2. NMHC QUARTERLY SURVEY OF APARTMENT CONDITIONS

- As of the NMHC's April 2023 survey, apartment investors across the US continue to report a challenging financing environment, with the availability of both debt and equity continuing to shrink.
- A majority (51%) of apartment operators report that conditions in their local markets are looser (higher vacancies, less rent growth) today than three months earlier. 34% of operators said conditions were unchanged compared to three months again, while just 14% reported a tightening.
- While the majority of investors (53%) report that now is a worse time for borrowers than three months ago, this share has started to drop off over the past two quarters. When asked in October 2022, a super-majority (90%) felt that borrowing conditions had worsened, and 0% reported an improvement. Fast forward to the April 2023 survey, this declining share has dropped by 37%, while 12% now say financing conditions are improving.
- Notably, while a majority of investors (64%) anticipate a continued bumpy landing thanks to the Federal Reserve's monetary tightening cycle, they do not anticipate a recession. Just 21% of respondents expect a hard landing with a recession.

3. CONSUMER CONFIDENCE

- According to data from the Conference Board, consumer confidence fell in April to 101.3, declining from a reading of 104.0 the month before.

- The present situation index, a snapshot of current business and labor market conditions, rose from 148.9 to 151.1.
- The expectations index, based on the shorter-term sentiment of income, business, and labor market conditions, fell from 74.0 to 68.1 in April. Moreover, outside of a brief uptick in December, the expectations index has been below 80 since February 2022.

4. MORTGAGE APPLICATIONS

- Mortgage applications climbed by 3.7% during the week ending on April 21st, 2023, an 8.8% fall in the previous week, according to the Mortgage Bankers Association.
- Mortgage application demand fell significantly during the second half of 2022 as mortgage rates rose steeply. After falling for much of December, mortgage applications increased to begin in 2023.
- Applications to purchase a home increased by 4.6%, while refinance applications rose by 1.7% during the week ending April 21st.
- Despite recession concerns, markets largely expect a 25 basis points hike by the Fed at their next meeting, which has placed upward pressure on treasury and mortgage rates.

5. OFFICE DEMAND

- Office demand is on the rise again, according to the latest data from VTS. The VTS Office Demand Index (VODI) rose by 31.3% between March and April.
- Historically, the month of March tends to experience a seasonal surge in office demand and occupancy. However, this year's surge is higher than in the previous five years. Still, since office occupancy remains below pre-COVID levels, similar increases in demand today will have an outsized impact on month-to-month growth than in previous years.
- That said, the VODI remains 4.5% below its March 2022 level, signaling a continuing long-term recession in office demand. However, the gap is narrowing. In February, the VODI was down by 12.5% from a year earlier.

6. MSCI RCA: APARTMENT

- Apartment cap rates ticked up again in Q1 2023, rising 19 bps from the previous quarter and settling at 5.0%. Compared to one year ago, apartment cap rates are up by 57 bps.
- Trends are similar across sub-asset types within the apartment sector. Both garden-style and mid/highrise apartments finished Q1 2023 with a 5.0% average cap rate. Moreover, both sub-asset types saw similar quarter-over-quarter changes, with garden and mid/highrise units rising by 17 bps and 18 bps, respectively.

- Apartment transaction volume totaled just $25.4 billion in Q1 2023 — the least active quarter on record since Q2 2020. Volumes declined 52% quarter-over-quarter and 64% year-over-year. Valuations have also fallen for their third consecutive quarter, dropping by 9.4% since reaching a peak in Q2 2022.

7. MSCI RCA: RETAIL

- For a third consecutive quarter, retail cap rates continued rising in Q1 2023. Retail cap rates sat at an average of 6.4% during Q1, rising 17 bps quarter-over-quarter and 34 bps year-over-year.
- Urban storefronts were the only retail sub-type not to see an average quarter-over-quarter cap rate increase, holding at 5.4%. Lifestyle/power centers and single-tenant retail assets also see favorable cap rate trends, posting mild quarter-over-quarter gains while maintaining year-over-year decreases.
- Retail transaction volume increased mildly (+0.1%) in Q1 2023, totaling $16.9 billion in sales. Still, the positive gain is noteworthy as other sectors saw a significant pullback last quarter. Measured, year-over-year, retail asset sales are down by 27.4%. Moreover, asset valuations have softened by a cumulative 7.6% over the past two quarters.

8. MSCI RCA: OFFICE

- The office sector has now seen cap rate increases in the past four quarters. Average office cap rates jumped again in Q1 2023, this time by 17 bps to land at 6.7%. Over the past year, office cap rates have risen, on average, by 54 bps.
- Suburban office cap rates have jumped 54 bps in the past year, rising to 6.8% through Q1 2023. Meanwhile, central business district (CBD) office cap rates have risen by a more gradual 32 bps, reaching 5.8%. Notably, CBD office cap rates did not meaningfully compress during 2021 as functional concerns were already impacting pricing.
- Office transaction volume cratered in Q1 2023, with just $10.7 billion worth of assets trading hands. Compared to the prior quarter, trading volumes sank 48.1%. Year-over-year, deal volumes fell 68.4%. Similarly, asset valuations continue to feel the heat of higher interest rates, dropping 2.8% quarter-over-quarter and 9.1% year-over-year.

9. MSCI RCA: INDUSTRIAL

- Despite strong fundamentals, the industrial sector has proven it is not immune to the effects of higher interest rates. Like the office sector, industrial assets have now seen cap rates rise in the past four quarters. Industrial cap rates have risen 12 bps quarter-over-quarter and 35 bps year-over-year through Q1 2023, landing at 5.5%.
- Single-tenant industrial space has seen the most dramatic increase in average cap rates over the past

year, rising by 63 bps to 5.7%.
- Transaction volume sank to its lowest quarterly amount in Q1 2023 since 2020, falling to $15.5 billion. The Q1 totals stand a decrease of 47.2% quarter-over-quarter and 54.4% year-over-year.

10. CASE-SHILLER HOME PRICE INDEX

- According to the S&P Case-Shiller National Home Price Index, negative pricing pressures may be starting to ease in the housing sector.
- As of February 2023, for the first time in eight months, home prices did not fall on a month-over-month basis. While the monthly gain was marginal (+0.2%), the directionality is meaningful.
- Through the February 2023 data point, average home prices are down from their June 2023 peak by just 2.7%. While higher interest rates have sapped new homebuyer demand, existing homeowners being locked into low mortgage rates has meant a lack of default distress. As a result, while buying activity has fallen off, the impact on pricing has been marginal.

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SUMMARY OF SOURCES

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