Commercial Real Estate Sector Preserves Strength, Despite Inflationary Headwinds

Markets predict Fed cut in March, even with bump in CPI. Headline inflation ticked up to 3.4 percent over the year ended December 2023, as both energy and shelter costs accelerated during the month. While this higher reading appears to complicate the Federal Reserve's stance on monetary policy in 2024, market probabilities for a rate cut in March actually grew over 500 basis points, to about 70 percent shortly after the CPI data release. The continued cooling of core inflation, which ticked down to 3.9 percent in the 12 months ended December, is signaling that most consumer prices — aside from food and energy — remain on a steady downward path from their highs noted in June 2022.

Strong demand for housing keeps shelter costs elevated. The shelter index, which tracks prices for various forms of housing, jumped 6.2 percent over the year ended in December and accounted for over half of the month's CPI increase. Structural drivers of apartment demand have grown stronger, after the Fed's clamp down on borrowing restricted homebuying during the last two years. The U.S. affordability gap — a measure of the difference between the monthly mortgage payment on a median-priced home and the average multifamily rent — reached a record of $1,300 in September, steering more prospective homebuyers to the rental market. This boost to demand will restrain the uptick in U.S. apartment vacancy to 30 basis points in 2024, despite record deliveries. Still, supply pressure will cool U.S. rent growth to a below-average 1.5 percent throughout the year. Over time, these more stable rents should help tamp down the core inflation metric.

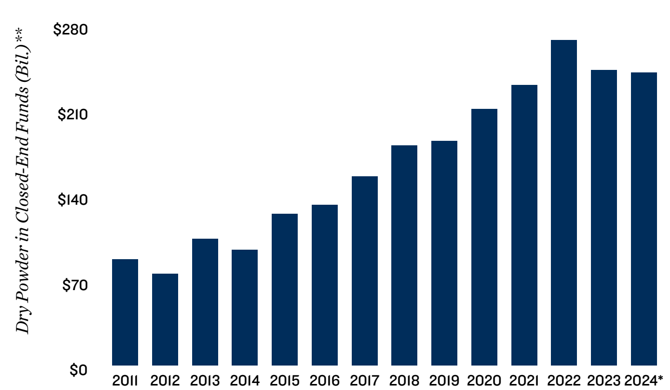
Gasoline prices point to recalibrating demand for industrial space. While the cost of gasoline rose in December, prices were at a near-annual low of $3.24 per gallon in the prior month, as U.S. inventories reached a 2023 high. This recent buildup of stock has been a signal of softening demand for gasoline, in part reflecting slowing operations within the logistics and warehousing sectors. Nationwide industrial vacancy rose by 170 basis points in 2023, with elevated inventory growth coinciding with some high-profile warehouse tenants like Amazon reducing their space requirements. Although industrial property metrics are rebalancing, the sector remains comparatively strong. The average asking rent for industrial properties will grow by 3.7 percent this year, marking the fastest gain of any major property type set for 2024.

Growth in retail sales outweighing inflation. While higher costs for food and energy were potential pitfalls for discretionary spending moving into the holidays, the retail sector preserved its strength. Inflation-adjusted core retail sales, which excludes restaurants, autos and gas, rose 2.0 percent in 2023. Although higher costs for goods have altered spending habits, with overall personal credit reaching a record at the end of last year, this consumer resilience bodes well for retailer performance in the coming months. U.S. retail vacancy will lift by just 10 basis points in 2024, despite a four-year high supply addition.

Deal flow poised to rise. The totality of these trends suggest many property owners fared well amid the worst of inflationary pressures, positioning trading to rally in 2024. Resilient consumer spending and lower, but still-positive, hiring are anchoring expectations for a soft landing, aiding investor confidence. Rate cuts this year should also narrow the buyer-seller expectations gap, enabling more deals to pencil. A near-record $240 billion of dry powder allotted to just Class A rentals reflects pent-up demand for commercial real estate assets as the trajectory of the economy and lending landscape becomes clearer.

3.4% *Increase in Headline CPI Year-Over-Year*	3.9% *Increase in Core CPI Year-Over-Year*

2024 Dry Powder Volume Just Short of All-Time High



**Estimate*

***Total amount of private equity capital raised by closed-end funds for targeting Class A apartments.*

Sources: Marcus & Millichap Research Services; Freddie Mac; Bureau of Labor Statistics; CME Group; Federal Reserve; RealPage, Inc.; Census Bureau; Bureau of Economic Analysis; CoStar Group, Inc.; Real Capital Analytics; Energy Information Administration; Preqin