AEW RESEARCH & STRATEGY

U.S. Economic & Property Market Perspective

Q3 2024

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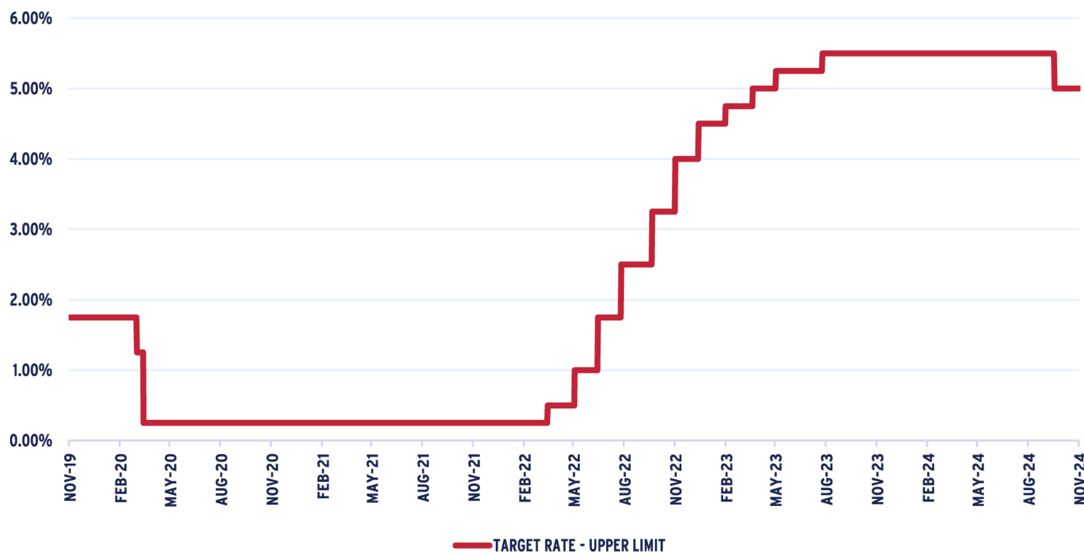
Research Update

U.S. Economic and Property Market Outlook

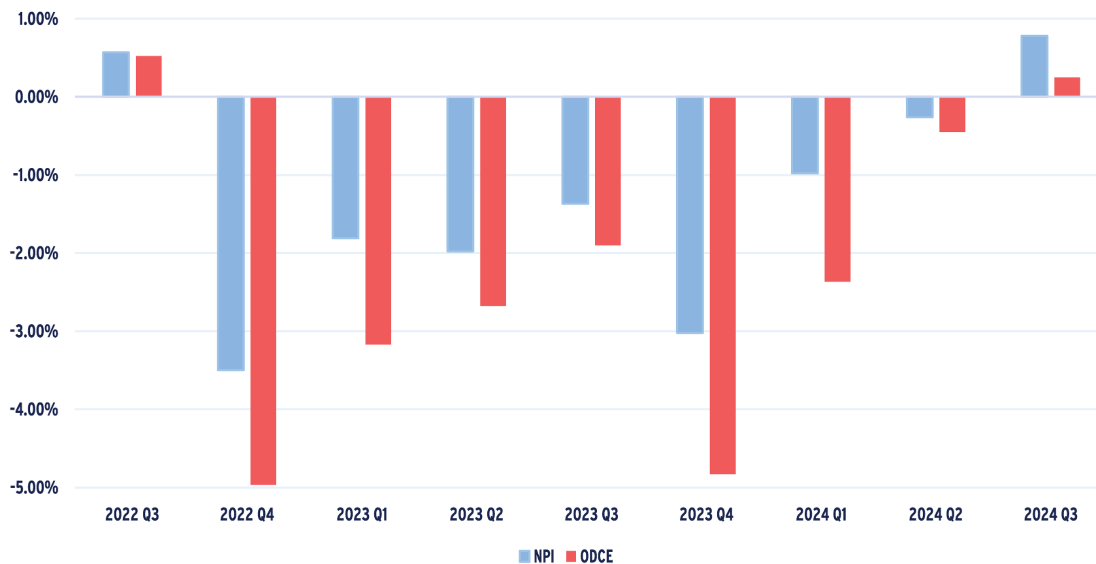
For property investors, the past quarter was marked by two significant and related developments. First, the Federal Reserve lowered interest rates for the first time since March 2020, dropping the target federal funds rate by 50 basis points in September. Second, property investment returns were, in aggregate, positive for the first time since the third quarter of 2022, likely signaling an approaching end to the current period of downward property valuation adjustment.

FIGURE 1: FEDERAL RESERVE TARGET FED FUNDS RATE



As of September 30, 2024
Source: Federal Reserve

FIGURE 2: CRE TOTAL RETURN

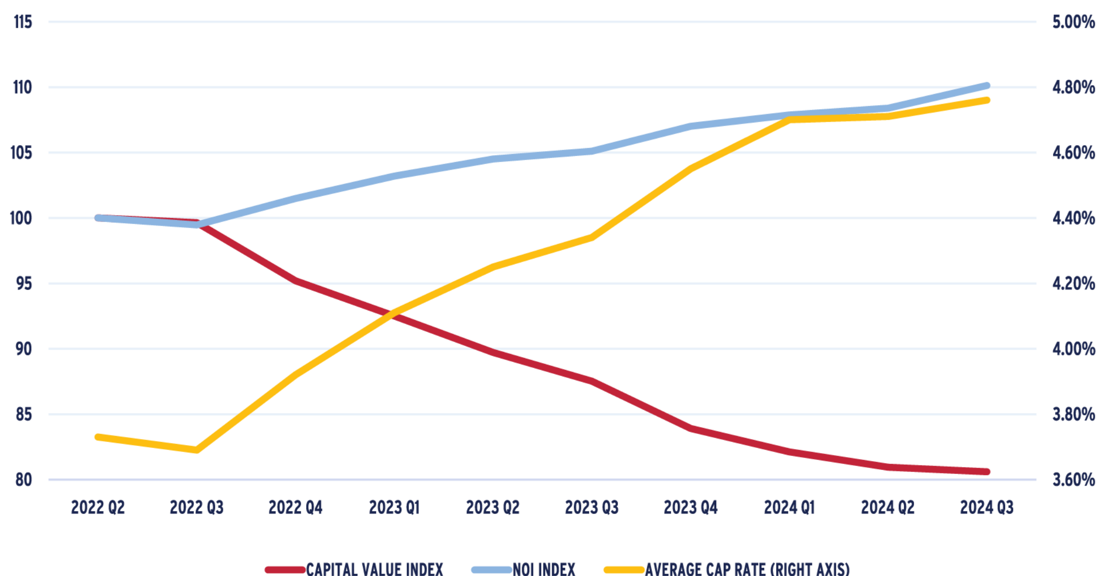


As of September 30, 2024
Source: NCREIF

While the third-quarter total return of the NCREIF Property Index (NPI) was positive, this total return included the ninth consecutive quarter of modest negative aggregate capital appreciation, isolated entirely in the office property sector. As noted last quarter, the current prolonged period of downward capital value adjustment (write down) is the first such period since the beginning of the NPI in 1978 to occur without a corresponding economic contraction (recession). Indeed, preliminary estimates for third-quarter real GDP growth suggests the U.S. economy continued to expand at an annual rate of slightly more than 2.8%, roughly in line with the average growth rate of the past two years and well above official estimates of potential GDP.

Consistent with a broadly expanding economy, property income has also recorded steady, albeit modest, growth over the past two years with aggregate same-property net operating income gains of approximately 10% (see Figure 3). Over the same period, the capitalized value of this income declined approximately 20%. This decline is fully explained by the aggregate NPI property cap rate rising from 3.7% to nearly 4.8%, an increase that would have produced more than 20% decline in value if applied to static property income. In other words, the aggregate change in property values since the middle of 2022 is due entirely to the change in interest rates by the Federal Reserve and the resulting increase in investor-required property yield.

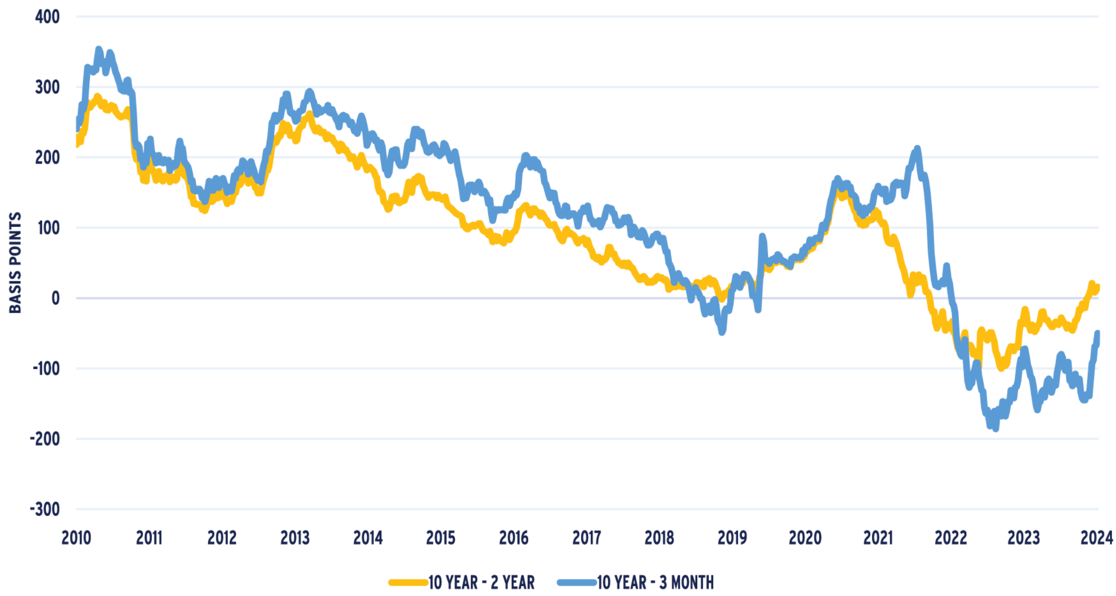
FIGURE 3: CAPITAL VALUES, NOI AND CAP RATE CHANGES OVER PAST NINE QUARTERS
INDEX=100 IN 2022 Q2



As of September 30, 2024
Source: NCREIF

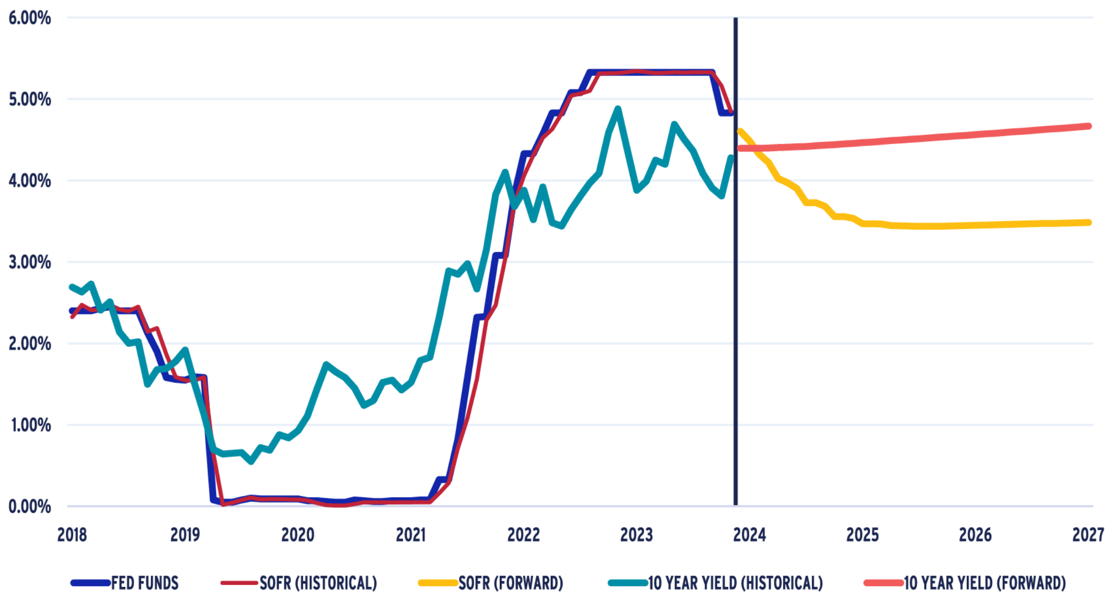
Given the interest rate effect on property valuations over the past two years, the move by the Federal Reserve towards lower policy lending rates should itself be positive for go-forward property values, particularly if economic growth, and by extension property income growth remains positive. The magnitude of any yield effect on property values will, of course, depend on the pace and ultimate magnitude of additional changes to the overnight lending rate by the Federal Reserve and, more importantly, the reaction to longer dated bond yields. That is, do investors return to more historically common term premia that produces an upward sloping yield curve or revert to recent experience of longer maturity yields falling below short-term interest rates?

FIGURE 4: YIELD SPREAD



As of September 30, 2024
Source: U.S. Department of the Treasury

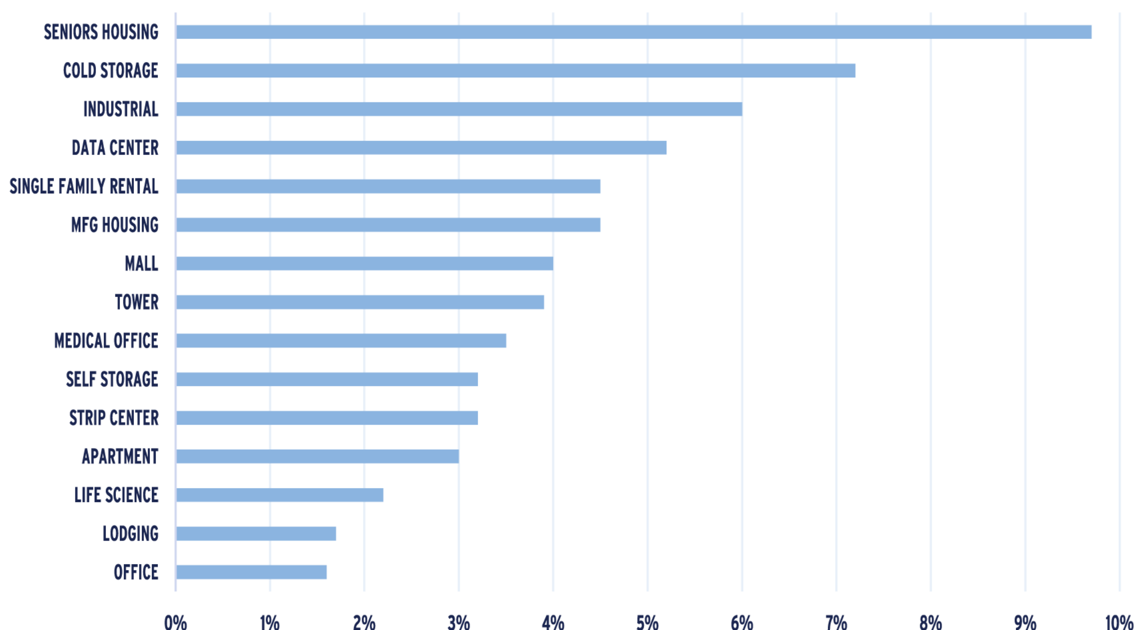
FIGURE 5: INTEREST RATE FORWARD CURVES



As of September 30, 2024
Source: Chatham Financial

Current bond market pricing (i.e., forward curves) indicate the market expects the Fed to bring down the overnight lending rate throughout 2025 to approximately 3.5% with the yield on the 10-year Treasury bond remaining near or above current levels. While the forward market is a notoriously poor forecaster of future interest rates, the current expected interest rate environment does not support significant near-term property yield compression. Rather, all of this argues for a period where the lion's share of property valuation improvement can come from growth in property net operating income (NOI). While all property sectors are expected to show positive NOI growth over the next several years, the range of near-term expected growth is quite wide. Green Street, for example, is currently projecting NOI growth prospects ranging from a low of approximately 1.5% for the office sector to more than 9% for seniors housing. Seniors housing, of course, was disproportionately impacted by the pandemic and is now enjoying an outsized recovery from those impacts.

FIGURE 6: EXPECTED AVERAGE ANNUAL SAME STORE NOI GROWTH BY PROPERTY SECTOR



As of September 30, 2024
Source: Green Street

Conclusion

U.S. commercial property has experienced a prolonged period of negative valuation adjustment over the past two years. Nearly all the change in values has been directly connected to the broader change in interest rates and asset yields resulting from the Federal Reserve's policy response to unacceptably high inflation following the pandemic. With inflation now seemingly waning, the Federal Reserve has reversed its policy of raising short rates and is expected to continue lowering interest rates through 2025. Investors have not, however, translated this into a similar expectation of lower yields on longer bonds (e.g., 10-year Treasury yield) and are instead anticipating a more typical upward sloping yield curve over the next several years. During the last two real estate valuation recovery periods following the Tech Crash (early 2000s) and the Financial Crisis (2008/2009), property investors enjoyed significant outsized total returns reflecting the combination of positive, albeit moderate, property income growth and rapidly compressing yields. For example, in the five years following the Financial Crisis (2010 Q1 – 2015 Q1, Figure 7), the NPI recorded a nearly 40% increase in capital value made up of a slightly less than 20% increase in aggregate NOI and nearly 200 basis point decrease in average yield.[1]

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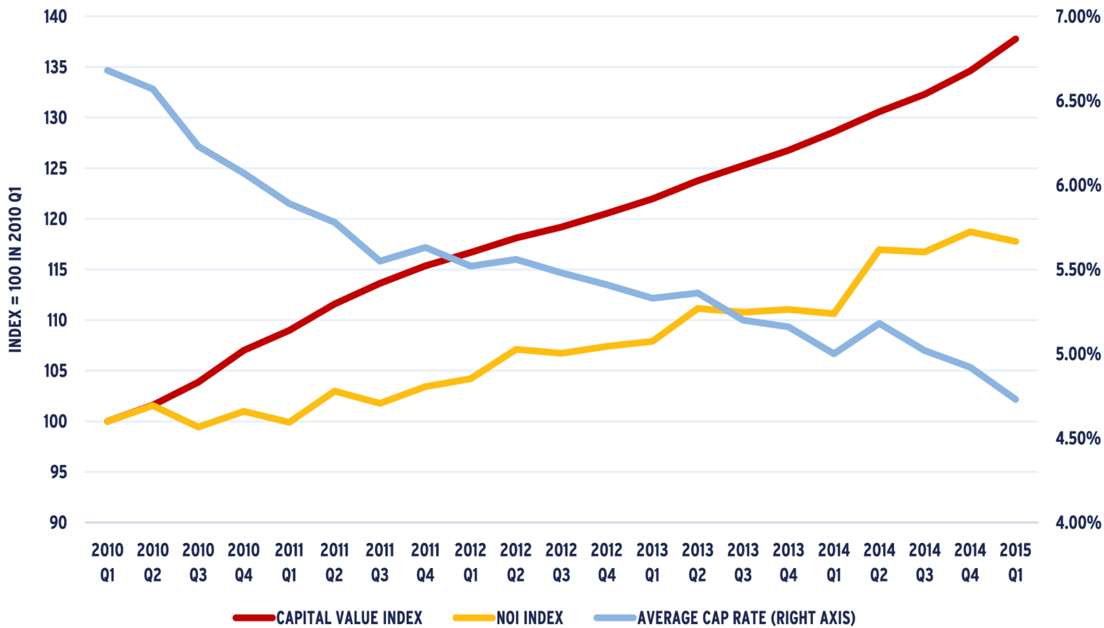
[1] *The comparable figures for the five years following the Tech Crash (2003 Q1 – 2008 Q1) are nearly identical.*

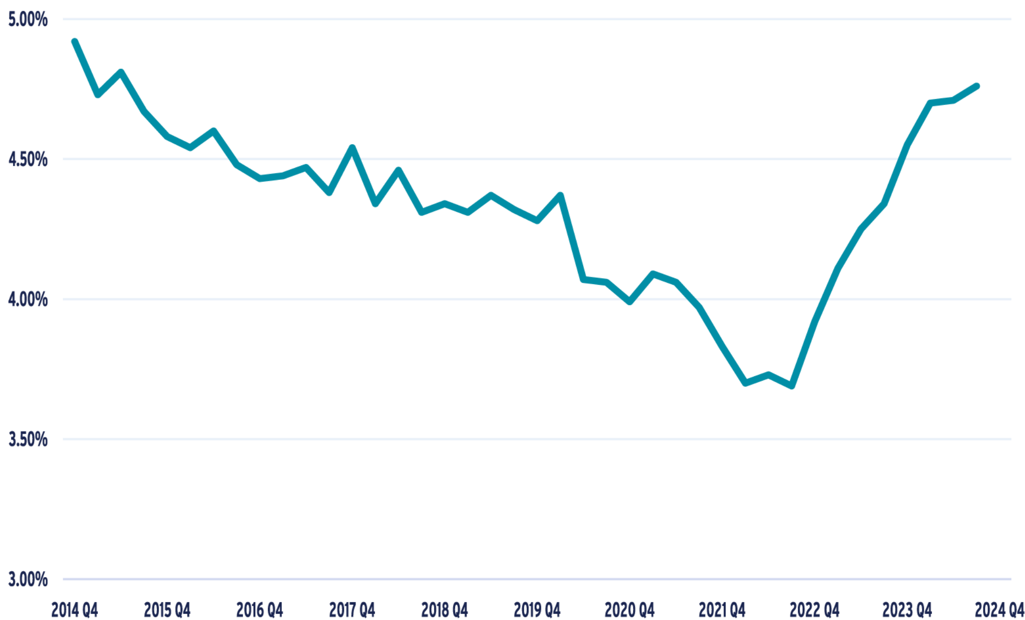
FIGURE 7: CAPITAL VALUE, NOI AND CAP RATE – FIVE YEAR PERIOD FOLLOWING FINANCIAL CRISIS PROPERTY VALUE DECLINE



As of September 30, 2024
Source: NCREIF

While outsized go-forward returns driven by significant property yield compression cannot be assumed today, we believe the current market represents the best entry point for commercial property investors in at least ten years for two specific reasons. First, the average NPI property yield (appraisal cap rate) is now at the highest level since the last quarter of 2014.

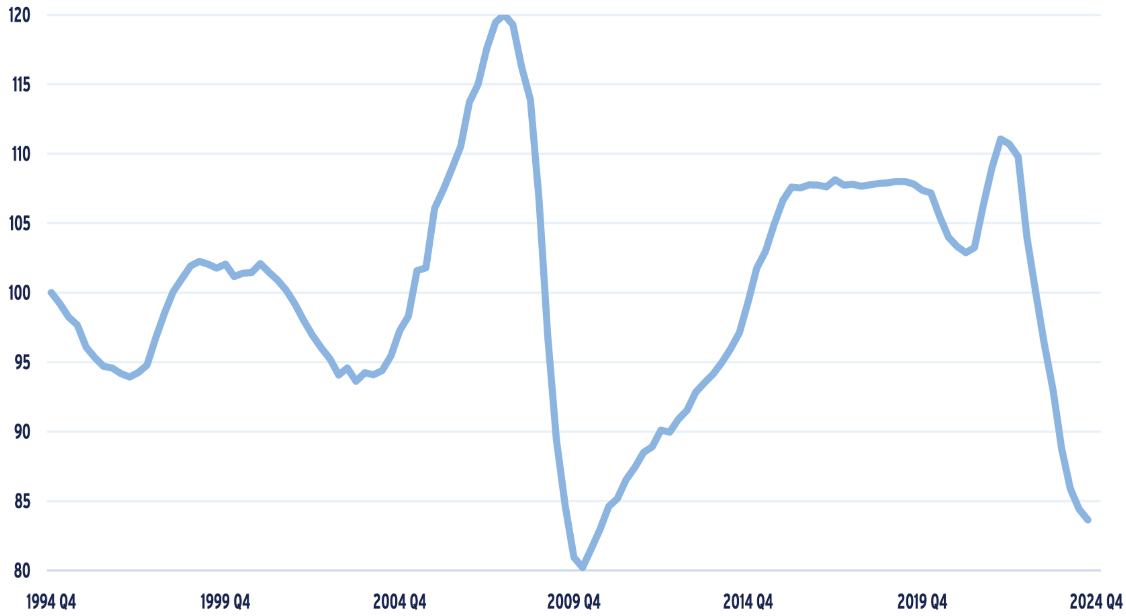
FIGURE 8: NPI APPRAISAL CAP RATE



As of September 30, 2024
Source: NCREIF

Second, and perhaps more significantly, the capital value component of the NPI, when adjusted for inflation, is at the lowest level since the fourth quarter of 2009, the trough of the Financial Crisis declines and, in hindsight, possibly the most attractive property investment entry point in the entire post-war period.

FIGURE 9: REAL (INFLATION ADJUSTED) NPI CAPITAL VALUE INDEX (=100 IN 1994 Q4)



As of September 30, 2024
Source: NCREIF, AEW Research

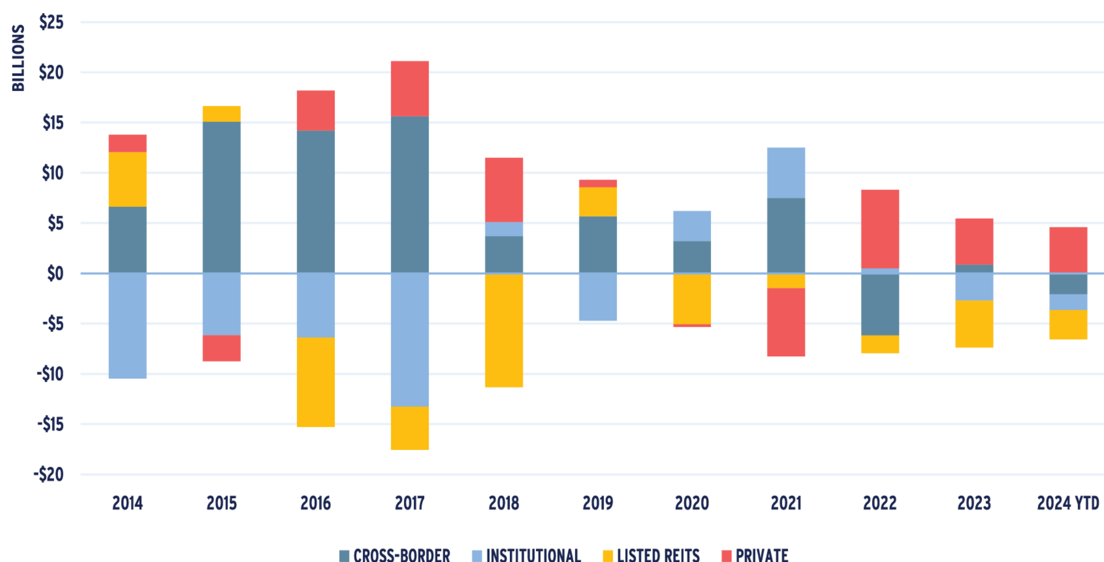
Property Sector Updates

Office

The more things change, the more they stay the same. It's a familiar saying first put to paper by a French critic back in 1849. This seems an appropriate sentiment for characterizing the office market in the current environment. Recent commentary and announcements have brought return-to-office back to the forefront as a topic of conversation. Amazon announced a more aggressive stance toward bringing employees back to the office, while in-office requirements continue to vary widely by firm. For some it means five days back in the office, while for others it means modifying existing policies to get folks in the office two or three days a week or simply modifying new-hire requirements. For the most part, these dynamics have been ongoing and can continue as both secular and cyclical shifts play out in the market. The pace of a correction in fundamentals does appear to be slowing but it seems early to suggest a bottom has arrived.

Office vacancy rates held steady in the third quarter at 19.0% with availabilities remaining above 25% despite positive absorption recorded for the quarter according to CBRE-EA. Sublease space continued to shrink as a share of overall vacancy at 2.3% of the total. while direct vacancy continued to drift higher to 16.7%. Despite the positive quarter, year-to-date net absorption remained negative (~3.0 msf) albeit a far cry from the pace of declines (~25.5 msf) through the first three quarters of last year. Leasing velocity had been trending steadily lower before holding its own in the third quarter at about 60% of pre-pandemic norms.

FIGURE 10: NET TRANSACTION VOLUME BY CAPITAL SOURCE



As of 3Q 2024
Source: MSCI/Real Capital Analytics

New supply remains less of a factor outside of select markets. The pipeline of projects under construction continued to unwind, hitting a cycle low of 46 msf. Seven markets (Boston, Dallas, Miami, Austin, Nashville, San Jose and Seattle) account for just over half of the remaining pipeline while the Top 10 markets (including Los Angeles, Atlanta and San Francisco) account for two-thirds of the pipeline. Miami/SE Florida, Austin, San Jose and Nashville are notable outliers with close to 5% or more of their respective inventory under construction, although San Jose is skewed by over one million square feet of single-tenant space Google is building.

As noted previously, companies have yet to fully adjust their space needs, especially those with longer contractual lease structures. Most smaller leases signed prior to 2020 have been exposed to the new market realities given their shorter duration, while larger leases (>10,000 square feet), which account for more than half of all leased space, have yet to roll. CoStar estimates 57% of leases signed prior to April 2020 have rolled leaving about 30% expected to come due before 2030 with the balance expiring farther in the future. Thus far, companies with the ability to adjust their space needs have shown a propensity to reduce their overall space as work-from-home adoption continues while upgrading the overall quality, a pattern

that is likely to continue for the foreseeable future as leases come due. As we highlighted last quarter, office employment growth has also downshifted, removing another incentive for companies to expand their space in the current environment.

The impact on values continues to play out with private equity adjusting at a more measured pace relative to the dynamics seen in the public markets. Through Q3 2024, NCREIF's capital appreciation index for office reflected an aggregate decline of 37% from previous highs, including a 17% adjustment over the past year and 2.5% adjustment for the quarter. Green Street's estimate of the overall price decline was a comparable 37% for higher quality assets with a bottoming taking place more recently with values off 3% over the past year. That said, the range of value impairment is wide depending on the market, quality of the asset and its relative distress. Confirmation of the value impairment is showing up in select trades although aggregate volumes remain depressed. Year-to-date transaction volume is tracking slightly ahead of last year's pace with Q3 volume also ticking up sequentially suggesting a potential low point has been reached. Approximately $42 billion changed hands through the first three quarters of 2024, or about 40% of the pace averaged prior to COVID. The notable shift has been the makeup of the buyer pool. While institutional capital and listed REITs remain marginally active buyers, they have been net sellers with the private buyer being the net buyer of office in 2024. More specifically, owner/users have seen their share of purchases increase from 12% to 25% of transactions over $5.0 million according to CoStar.

The pressure to transact appears to be increasing, coinciding with the amount of office debt maturing over the near-term. Distress is apparent as banks and other lenders increase loan-loss reserves and the CMBS market reports a rising percentage of office loans in special servicing and delinquency. The 30-day office delinquency rate stood at 8.4% in September to close the quarter and increased another 100 basis points in October according to Trepp. Outstanding CMBS office loans in special servicing closed the quarter at 12.6%. Correspondingly, financing is highly constrained with many lenders (and owners) looking to reduce their office exposure. Lender-facilitated sales are becoming more common solutions to monetizing the most challenged assets. Publicly traded REITs and institutional investors have been reducing their exposure to traditional office assets, while high net worth and private investors have been more active net buyers. Overall, the office market dynamics remain challenging with few signs suggesting a settling out in the capital markets or fundamentals near-term.

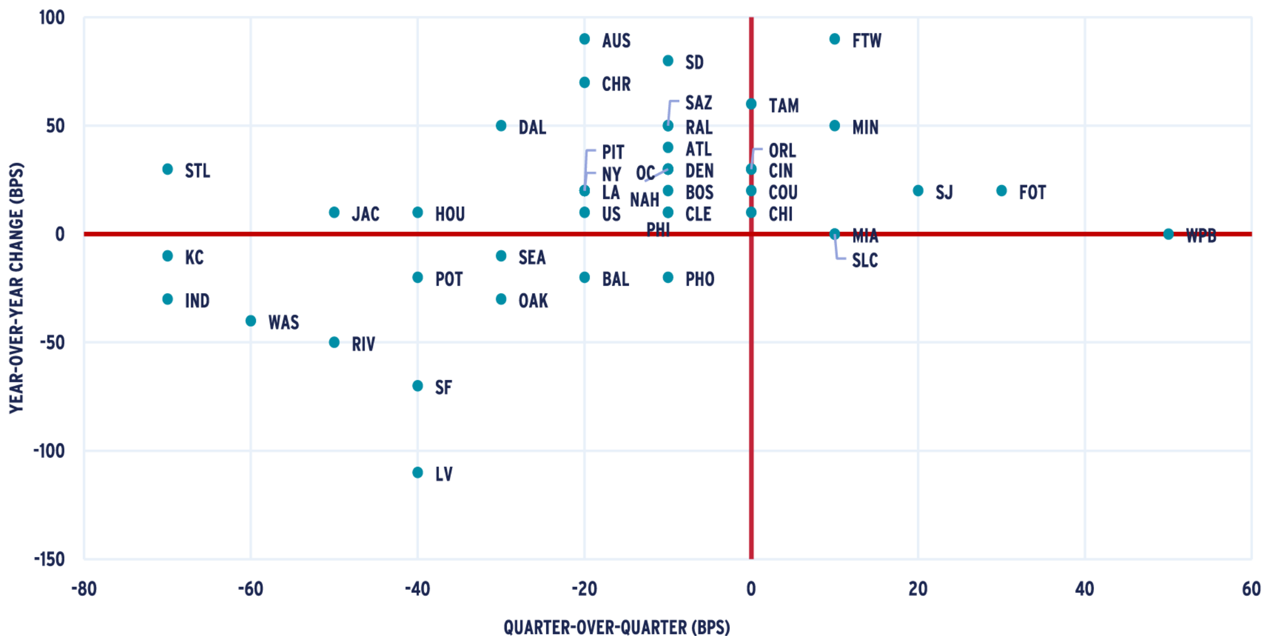
OFFICE	
VACANCY RATE	19.0%
12-MONTH HISTORICAL TREND	
VACANCY CHANGE	↑
RENT	↓
ABSORPTION	↓
COMPLETIONS	↓
CAP RATES	↑
TRANSACTION VOLUME	↔

Apartment

Apartment vacancies declined 20 basis points (bps) in the third quarter to 5.3%, marking the second consecutive quarterly decline in vacancies. Demand continued to accelerate with 153,300 units being absorbed on a net basis in the quarter and nearly 427,000 units over the previous four quarters; this puts demand at double the pace of the 5-year pre-COVID rolling four-quarter average. While demand has accelerated, supply has peaked. Net absorption outpaced completions by roughly 29,000 units or 23%, the largest spread in demand and supply since early 2022.

Regionally, all but ten markets reported flat or declining vacancies quarter-over-quarter. The greatest improvement in vacancies on the quarter generally occurred in Midwest markets; however, a few Sunbelt markets – Jacksonville, Riverside, Houston, Las Vegas and Dallas – also reported above-average reductions in vacancies. Notably, Austin reported its first quarterly decline in vacancy in since early 2022. On a year-over-year basis, vacancies were up 10 bps nationally; regionally, however, 25 markets reported a contraction in vacancy, including Las Vegas (-110 bps to 6.1%), San Francisco (-70 bps, 4.2%), Riverside (-50 bps, 4.8%) and Oakland (-30 bps, 5.2%). We expect further improvement in vacancy across all markets as supply continues to slow and demand remains solid.

FIGURE 11: MOST MARKETS REPORTED QOQ VACANCY DECLINES AND A NUMBER REPORTED YOY DECLINES

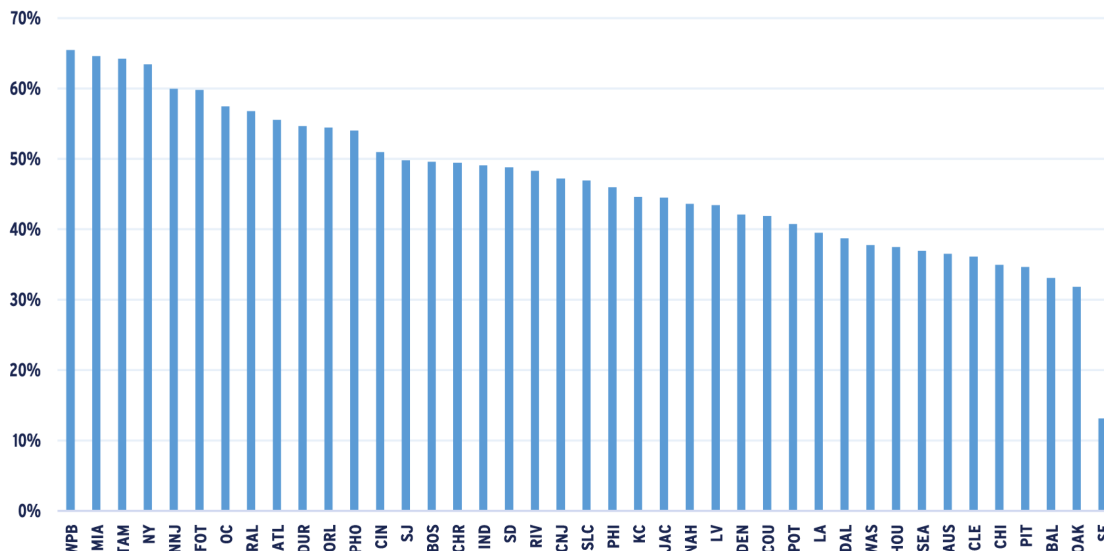


As of 3Q 2024
Source: CBRE-EA

A lack of affordability on the homeownership side, a relatively stable economy and favorable demographics are lending support to rental demand and should continue to do so going forward. Indeed, according to Moody's Analytics, affordability remains near a 40-year low. Further, since the beginning of 2020, nationally, the median home price has increased 45% to a record high of nearly $402,000 in 2024 Q2, 80% higher than the pre-GFC peak. Further, the gains in Southeast Florida, Tampa, the New York/NJ region, Orange County, Raleigh, Atlanta, San Jose, Orlando, Boston and Charlotte have far outpaced the national gain with home prices advancing between 50% and 66% . Notably, even Cincinnati (51%) and Indianapolis (49%) saw above-average gains. The increase in home prices has been nearly double that of incomes, with the median household income rising 25% from roughly $66,100 at the end of 2019 to $82,300 in mid-2024. Again, there has been significant variation by metro area with many Sunbelt markets (Jacksonville, Phoenix, Miami, Salt Lake City, Durham, Atlanta and Tampa) reporting the greatest gains (in excess of 30%). The more rapid increase in home prices relative to incomes and the near

doubling of mortgage interest rates have combined to sharply erode homeownership affordability and prop up demand for apartments. The long-term outlook for home price appreciation remains favorable; this, coupled with still relatively high mortgage rates should keep affordability low and inhibit renter movement to homeownership.

FIGURE 12: POST-COVID HOME PRICE APPRECIATION



As of 2Q 2024
Source: CBRE-EA

At the same time, while job growth has slowed, it remains positive and impactful. Indeed, payroll employment has expanded by 2.4 million positions over the previous four quarters while unemployment has remained low at only 4.1%. The still-strong labor market has supported the formation of an estimated 1.1 million households over the past year, roughly 7% above the rolling four-quarter 5-year pre-COVID average. The above-average increase in household formation could still be the unwinding of young adults moving out of their parents' homes post-COVID. Per the PEW Research Center, 52% of young adults aged 18-29 lived at home with their parents during the height of COVID in July of 2020, up from 47% in July of 2019. Going forward, the population of young adults (aged 20-29) is expected to increase by roughly 240,000; this could yield new demand of between 85,000 and 100,000 apartment units among this age cohort alone, if 50% of this increase translates to new household formation and current rentership rates hold. The growth among young people and continued population growth in general will likely lend further support to rental housing demand.

Overall, with positive demand drivers and slowing construction, the stage is set for a continued recovery in market fundamentals. With vacancies expected to decline in the coming years, particularly in the harder hit Sunbelt markets, we expect the market will shift from a tenant's market to a landlord's market, allowing for a recovery in rents. Indeed, we expect 'pops' in rents in many Sunbelt markets over the course of the 2026 to 2028 period. This should shore up NOI growth. At the same time, we believe capital values are at or near bottom which should yield healthy, outsized total returns relative to treasuries over the coming years. Indeed, the PREA consensus survey projects a total apartment return of 5.7% in 2025 before accelerating to 7.3% in 2026.

AEW

RESIDENTIAL

VACANCY RATE	5.3%
12-MONTH HISTORICAL TREND	
VACANCY CHANGE	↔
RENT	↔
ABSORPTION	↑
COMPLETIONS	↔
CAP RATES	↑
TRANSACTION VOLUME	↑

Industrial

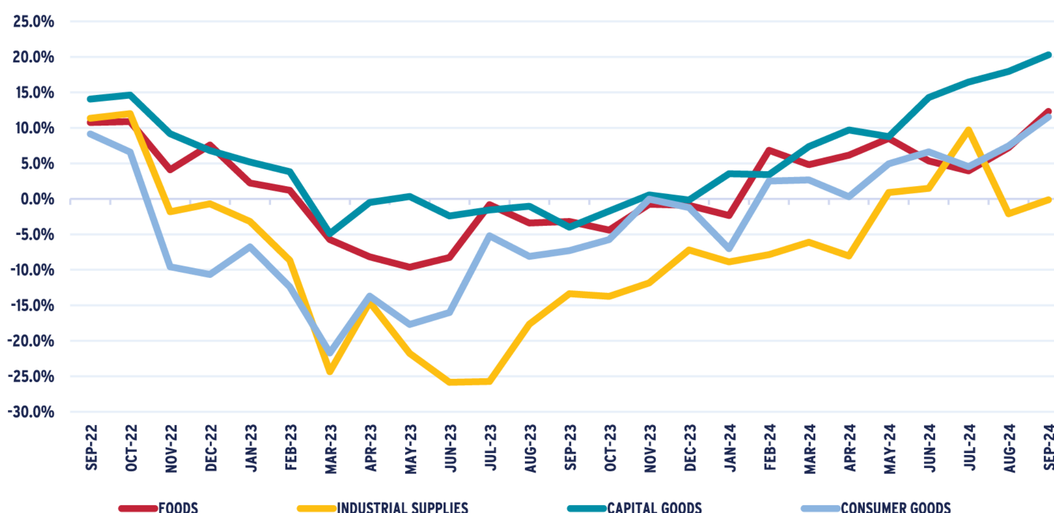
The industrial market continues to signal a bottoming out of fundamentals. Availability edged only modestly higher to 8.3% in the third quarter of 2024; the 10-basis point increase in the quarter was the smallest gain in nearly two years. Moreover, demand accelerated with net absorption totaling nearly 39 million square feet (msf) in the quarter, a 42% increase from the previous quarter and a significant improvement from the negative net absorption of 23.7 msf in the first quarter of the year. While the pickup in demand is positive news, demand remains roughly half the 5-year pre-COVID quarterly average. At the same time, the pace of construction, although slowing, remains strong and above average. Completions totaled roughly 68 msf in the quarter, bringing the four-quarter completion total to over 400 msf. Again, while this is a hefty total, it is down from the nearly 500 msf delivered in all of 2023. Overall, the moderation in supply growth, coupled with the acceleration in demand, limited the uptick in availability.

Green shoots are plentiful in the market, however, indicating a recovery in fundamentals is imminent. First, the return of Amazon, the largest industrial tenant nationally, is a clear signal fundamentals are set to improve. Following a more solid performance for the e-commerce giant in late 2023 and year-to-date, Amazon has reaccelerated building out its distribution network. As of June 30, 2024, Amazon reported 12-month revenue of $604.3 billion, a 12.3% year-over-year increase, and a gross profit of $225.2 billion, an 18.5% increase. Per CoStar, from June 30, 2023, through November 1, 2024, Amazon has executed 53 leases, including 17 for 1+ msf, totaling 24.4 msf in aggregate. This is up from only 19 leases totaling 9.6 msf over the same period in 2022-2023.

In addition to the turnaround from Amazon, the available space for lease rose at its slowest pace in 2024 Q3, while sublease availability is also stabilizing. Further, industrial demand drivers have improved with retail sales (excluding motor vehicles and parts, and gasoline stations) up 3.7% year over year (YOY) in September, the largest YOY gains since March and well above the sub-3% gains in January and February of this year. The continued downward trend in inflation and continued wage gains is also likely adding support to consumer spending.

Imports of goods have also accelerated recently, despite the brief longshoremen's strike at East Coast ports. Imports of goods rose 3.8% month over month (MOM) in September, increasing to $282.4 billion. The increase in imports was broad based with higher spending on consumer goods (5.8% MOM), foods, feeds and beverages (4.6%), industrial supplies (3.8%), capital goods (3.1%) and automotive vehicles (3.1%) contributing to the overall gain. On a YOY basis, the fastest growth in import demand has been in capital goods, likely reflecting the demand from the U.S. tech industry for new, high-powered computer chips central to their investment in artificial intelligence. Imports of consumer goods (11.5%) and foods, feeds and beverages (12.3%) have also seen double-digit growth over the last year.

FIGURE 13: STRONG IMPORT GROWTH IS AIDING IN THE DEMAND RECOVERY (YEAR-OVER-YEAR GROWTH SELECT CATEGORIES)

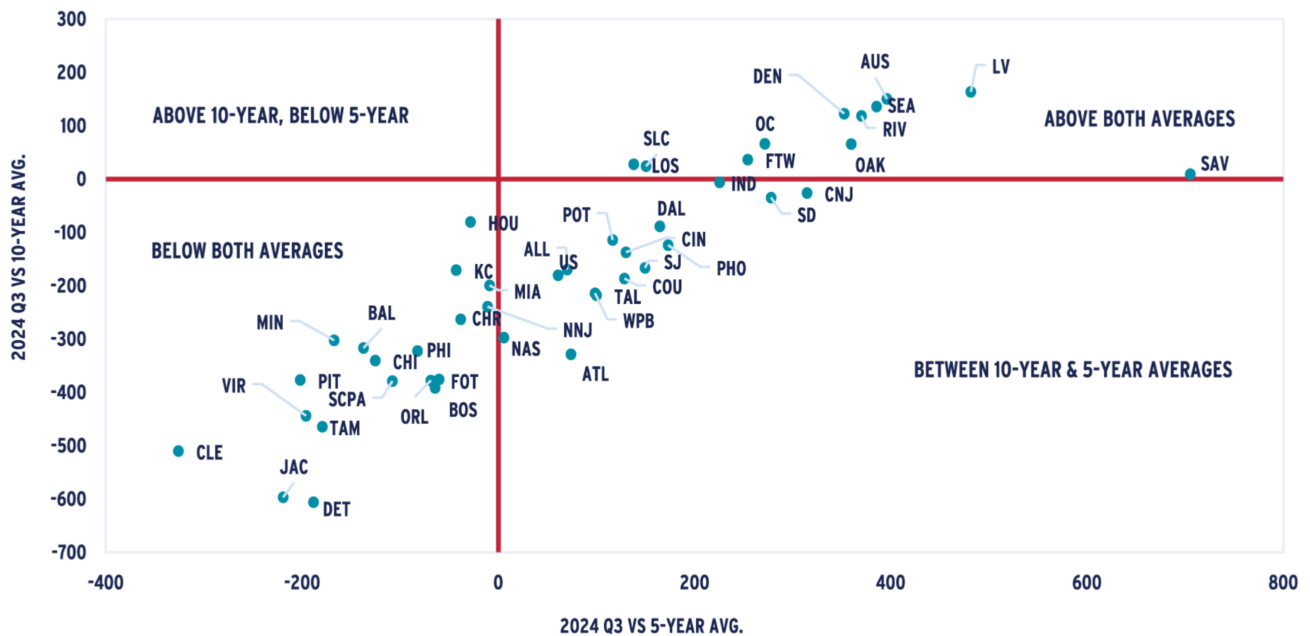


As of 3Q 2024
Source: U.S. Census Bureau

Further, according to the Journal of Commerce, imports from Asia are holding up and extending the peak season ahead of Black Friday. Typically, leading up to Black Friday blank sailings[2] pick up and import demand tapers off; this is not the case this year as retailers stock up due to 1) tariff concerns, 2) the potential expiration of the current labor agreement at East Coast and Gulf ports and 3) the frontloading of spring merchandise due to an early Lunar New Year in Asia. Indeed, peak season demand and vessel load factors have been strong over the summer and fall, leading to a 16.7% YOY increase in U.S. imports from Asia in September. Per PIERS, the 1.72 million TEUs imported from Asia remains near a two-year high. Again, this is an indication of the continued willingness of consumers to spend, which should help bolster the expected recovery in the industrial sector.

Regionally, 28 markets reported flat or declining availability in the quarter, including Los Angeles, Riverside, Atlanta, Houston, Seattle and Dallas/Fort Worth which had experienced some of the largest increases in availability in recent quarters. The directional change in availability in the aforementioned markets is encouraging given their size, importance to the overall industrial market and their economic impact. Furthermore, it should not take long to right the ship in most markets as availability generally sits between the 5- and 10-year pre-COVID averages or below both. Even gateway markets are positioned for a quicker recover as availability in most is only slightly above the 10-year pre-COVID average. Indeed, Riverside and Seattle are the only gateway markets where availability is over 100 bps above the 10-year pre-COVID average. With demand picking up and supply growth quickly ebbing, a more solid recovery is expected across the industrial market in 2025 and 2026.

FIGURE 14: AVAILABILITY RATES RELATIVE TO PRE-COVID AVERAGES (BPS DIFFERENCE)



As of 3Q 2024
Source: CBRE-EA

[2]*Blank sailing is when a shipping line or carrier skips a particular port or an entire voyage of a scheduled sailing route.*

Importantly, with market fundamentals essentially at bottom and the monetary tightening cycle ending, valuations are likely also at bottom and should pick up in the coming quarters. Per NCREIF, industrial appreciation was essentially flat in 2024 Q3, ending a two-year depreciation cycle. Further, industrial cap rates appear to be stabilizing, following a roughly 120 bps expansion over the previous two years. Going forward, with fundamentals improving and the Fed expected to continue cutting interest rates through 2025, valuations are expected to rise. Indeed, per the 2024 Q3 PREA Consensus survey, industrial capital values are expected to increase 2.3%, the largest gain among the four core property sectors; this combined with solid income is expected to yield a total return of 6.5% for 2025. Returns are expected to accelerate beyond 2025, signaling the final quarter of this year and into next year is a reasonable entry point for investors to take advantage of the shift in the market.

INDUSTRIAL	
AVAILABILITY RATE	8.3%
12-MONTH HISTORICAL TREND	
AVAILABILITY CHANGE	↑
RENT	↓
ABSORPTION	↑
COMPLETIONS	↓
CAP RATES	↑
TRANSACTION VOLUME	↔

Retail

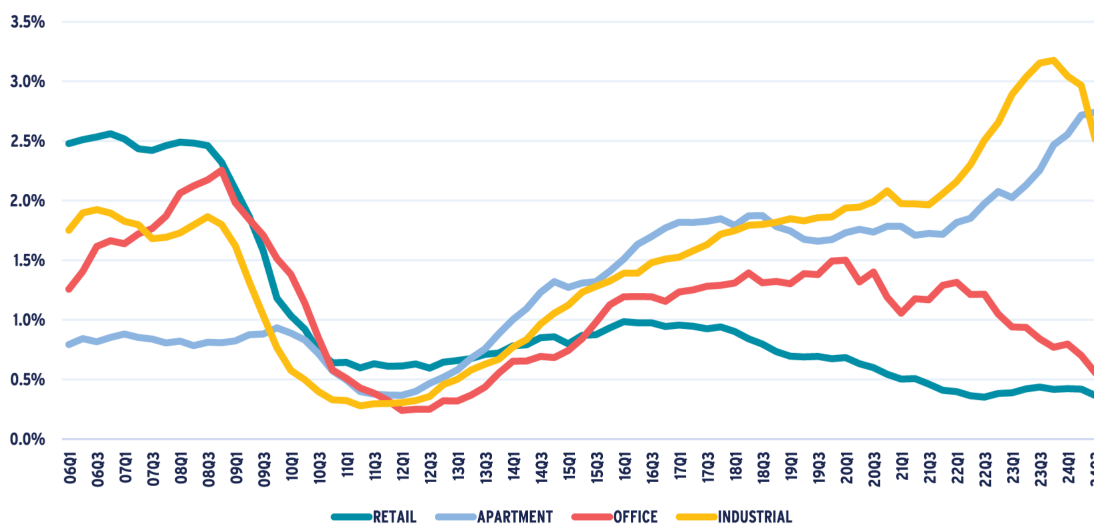
Retail sector fundamentals remain the tightest among the four core property types. Total retail availability remained flat at 4.7% for the fourth consecutive quarter, well below apartment and office vacancies of 5.3% and 19.0%, respectively, and industrial availability of 8.3%. Further, retail availability is down nearly 200 basis points (bps) from a late-2020 COVID peak of 6.6%, while apartment, office and industrial vacancy/availability rates are up 50 bps, 500 bps and 110 bps, respectively, from the same period. Moreover, apartment (60 bps), office (620 bps) and industrial (60 bps) vacancy/availability are all above their 5-year pre-COVID averages, while retail availability is 190 bps below the 5-year pre-COVID average.

The strength in the retail market extends to all three retail subtypes. Availability in the neighborhood and community shopping (NCSC) segment of the market stood at 6.5% in 2024 Q3, flat quarter-over-quarter (QOQ) and down 10 bps year-over-year (YOY); further, availability in the subtype is well below the 5-year and 10-year pre-COVID averages and the long-term historical average (2005 – 2015) of 9.6%, 10.9% and 10.8%. Meanwhile, power center (PC) availability continued to linger in the upper 4% to low 5% range, ending the quarter at 5.0%, up 10 bps QOQ but down 30 bps YOY. Like the NCSC segment of the market, PC availability is well below historical averages of 6.2%, 6.5% and 6.5%, respectively. Both the NCSC and PC segments of the market have shifted to a landlord's market and rent growth is expected to accelerate as a result.

Finally, the harder hit lifestyle and mall (L&M) segment of the market is also showing considerable improvement with availability of 5.5% in the quarter, flat QOQ but down 50 bps YOY. Unlike the NCSC and PC market segments, however, the L&M sector still has a bit to go before it fully recovers with availability sitting between the 5-year (5.2%) and 10-year (5.6%) pre-COVID averages and well above the long-term historical average of 4.7%.

The absence of new supply, unlike the other core property types, is lending particular support to the retail market. Indeed, new completions have totaled less than 0.5% of new inventory on a rolling four-quarter basis since the end of 2021 and less than 2.0% since early 2009. In contrast, apartment and industrial have delivered more than 2% of stock since mid-2022 and late-2020, respectively. Even office development, which has been more modest relative to apartment and industrial, has had a completion rate that has far outpaced the retail sector over the 2015 to 2023 period. Going forward, supply is expected to remain muted with only 0.4% of stock underway (29 msf) and pre-leasing is exceptionally strong at 71%, leaving less than 9 msf of the pipeline available.

FIGURE 15: NEW SUPPLY HAS SOFTENED FUNDAMENTALS IN ALL BUT RETAIL (ROLLING 4-QUARTER COMPLETIONS AS A SHARE OF INVENTORY)

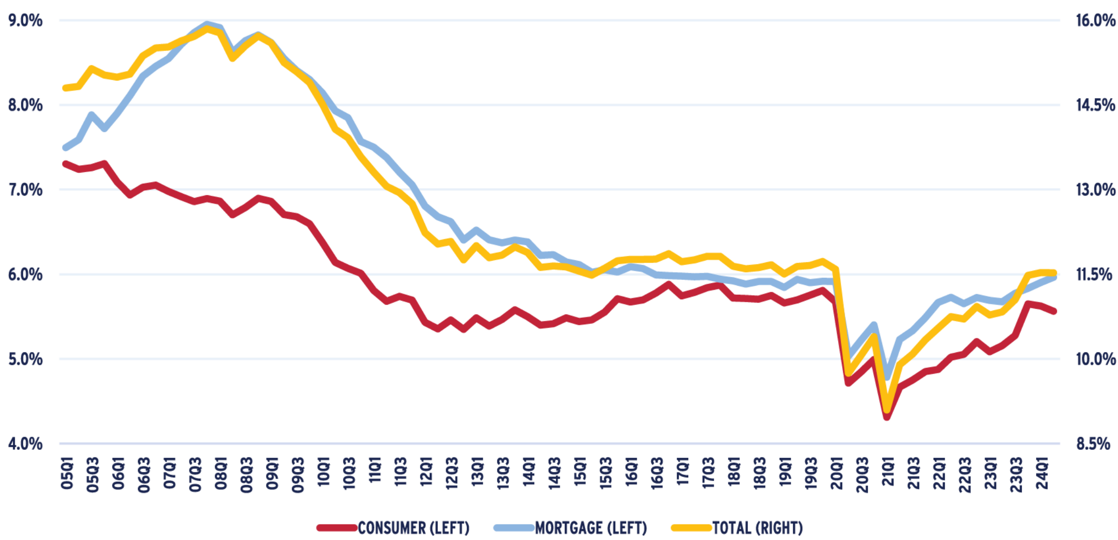


As of 3Q 2024
Source: U.S. Board of Governors of the Federal Reserve System; Household Debt Service and Financial Obligations Ratios; Moody's Analytics

On the demand side, meanwhile, net absorption has been somewhat constrained by the lack of available space. On a rolling four-quarter basis, demand has essentially been equal to supply for the past year and half. Additionally, while store closures have picked up in recent quarters, they have been offset by store openings. The willingness of consumers to keep spending is providing support for store openings among winning concepts, offsetting weaker concepts/performers that are going out of business. Indeed, retail and food service sales (excluding motor vehicles and parts and gasoline stations) increased 3.7% YOY in September, a marked acceleration from the sub-3% gains at the start of the year. Overall, the consumer is seemingly undeterred from the record-high credit card debt they are carrying and today's higher interest rate environment. The continued downward trend in inflation and continued wage gains may be offsetting some of the impact of higher interest rates, allowing consumers to keep spending.

Going forward, while we are cautious with respect to the consumer, given the historic peak in credit card debt, their overall debt burdens as a share of income remain relatively low. This low debt burden should help to keep consumer spending positive. Additionally, the Millennial population, the largest generational cohort today, is entering their prime wage earning and spending years. As they continue to age, form their own households and hit milestones like parenthood, their spending should accelerate. A risk to this outlook is a potential recession, which could force a pullback in spending and impact retail demand. That said, there will likely be variation among subtype performance in a recessionary scenario. Overall, we expect necessity-based and off-priced retail will likely outperform in general, but even more so in a recessionary environment. More discretionary retail product, like lifestyle centers and malls, would likely be more adversely affected by a potential downturn.

FIGURE 16: HOUSEHOLD DEBT SERVICE RATIO AS A SHARE OF DISPOSABLE INCOME



As of 2Q 2024
Source: U.S. Board of Governors of the Federal Reserve System; Household Debt Service and Financial Obligations Ratios; Moody's Analytics

Given fundamentals today and the continued strength expected in the retail market, we anticipate total returns will to likely pick up in the coming years, driven by stable income growth and modest appreciation. Overall, per the PREA Consensus Survey, the retail sector is expected to produce the strongest return over the next few years with an annual expected return of 6.9% over the 2024 to 2028 period, outpacing the industrial (6.5%), apartment (6.4%) and office (2.3%) returns.

RETAIL	N&C SHOPPING CENTER	LIFESTYLE & MALL	POWER CENTER
AVAILABILITY RATE	6.5%	5.5%	5.0%
12-MONTH HISTORICAL TREND			
AVAILABILITY CHANGE	↓	↓	↓
RENT	↑	↑	↑
ABSORPTION	↔	↔	↔
COMPLETIONS	↓	↓	↓
CAP RATES	↑	↑	↑
TRANSACTION VOLUME	↓	↓	↓