



REALTORS' ASSOCIATION OF SOUTH CENTRAL WISCONSIN

Economic and Real Estate Review and Forecast: 2019

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History shows us that the worst transactions are done at the best of times.... now is the perfect time to be cautious.

Presentation Outline

- I. The National Economy
 - Reasons for Caution
 - It is the best of times
 - Wages / Employment / Inflation

- II. Real Estate Capital Markets

- III. The Wisconsin Market

The
Economist

OCTOBER 13TH-19TH 2018

Dirty capital: the City of London

The fate of Jamal Khashoggi

Medicare for all

Vegans on the rampage

The next recession

How bad will it be?



WISCONSIN
SCHOOL OF BUSINESS

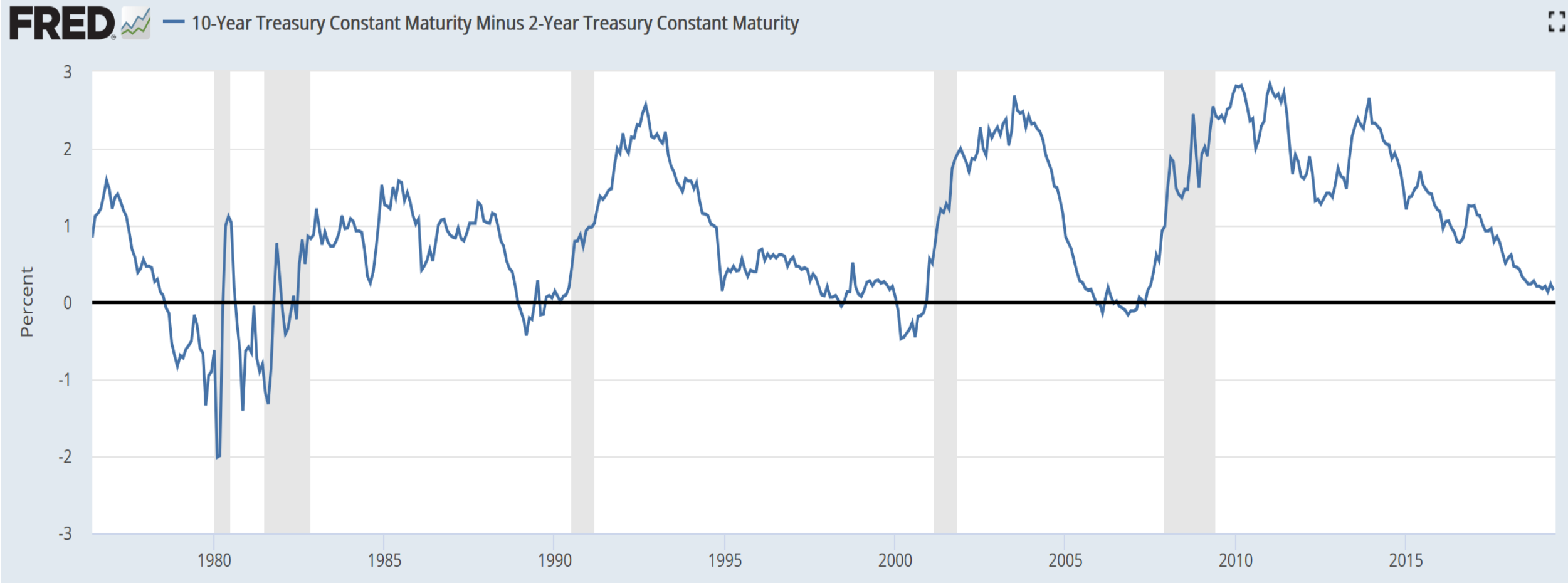
UNIVERSITY OF WISCONSIN-MADISON

TOGETHER FORWARD®

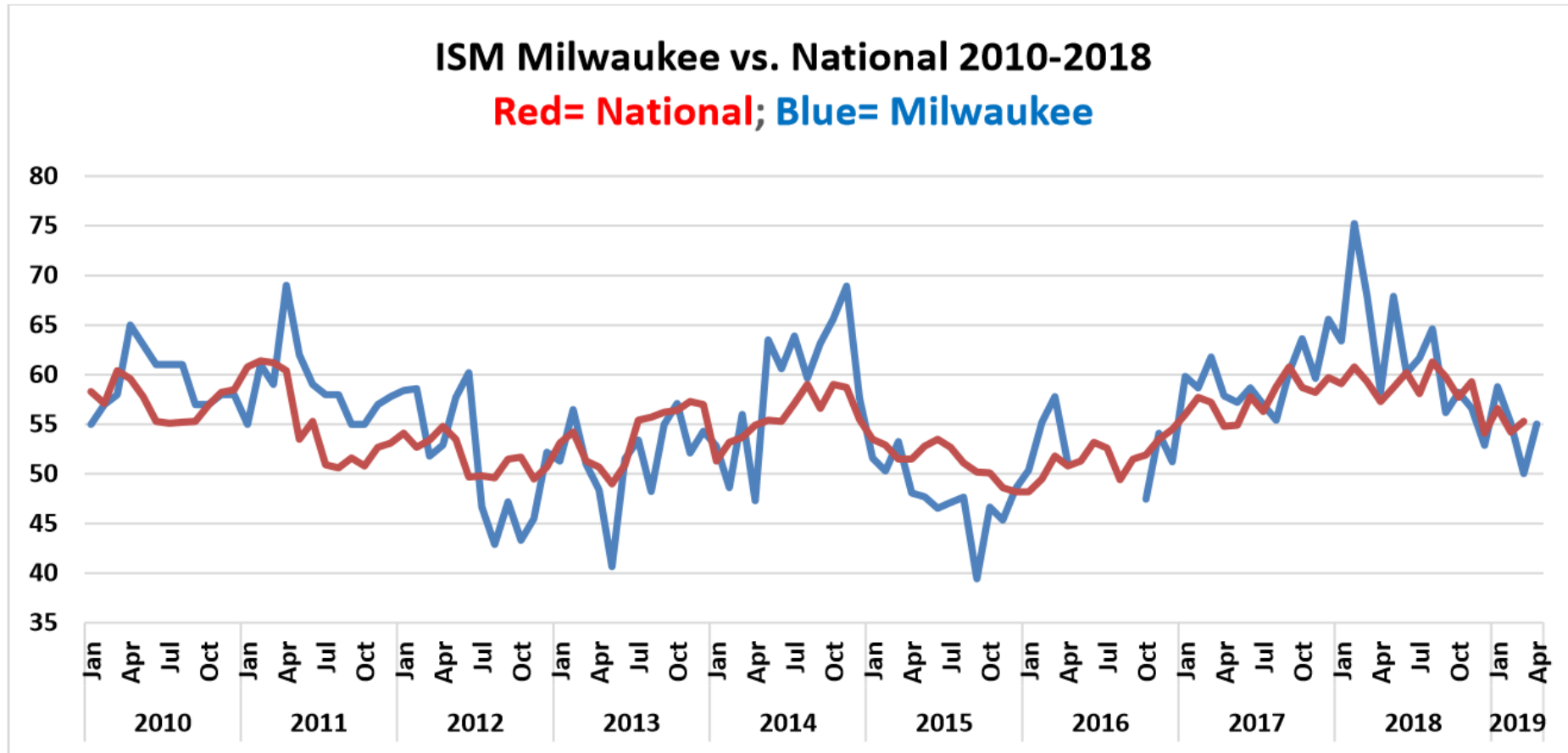
JAMES A. GRAASKAMP
CENTER *for*
REAL ESTATE

Source: Economist,
October 13-19, 2018

The inverted yield curve (10 yr. v. 2 yr.), a solid a recession predictor



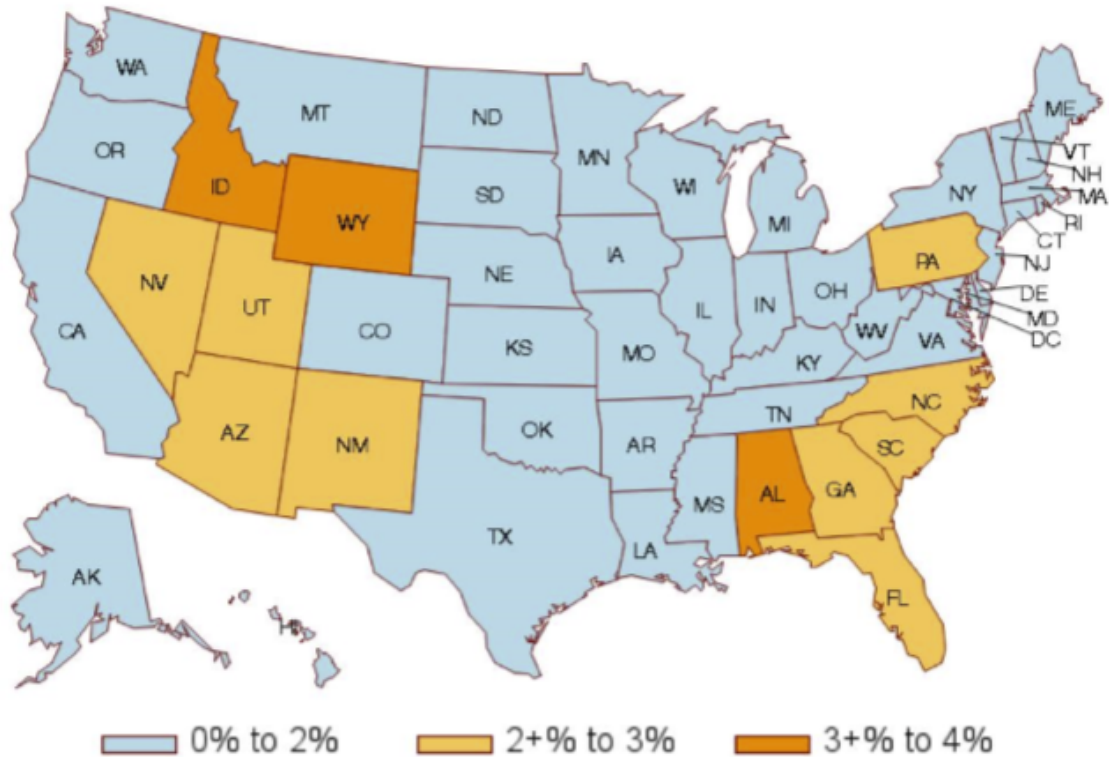
. . . . manufacturing is flagging nationally and in Wisconsin



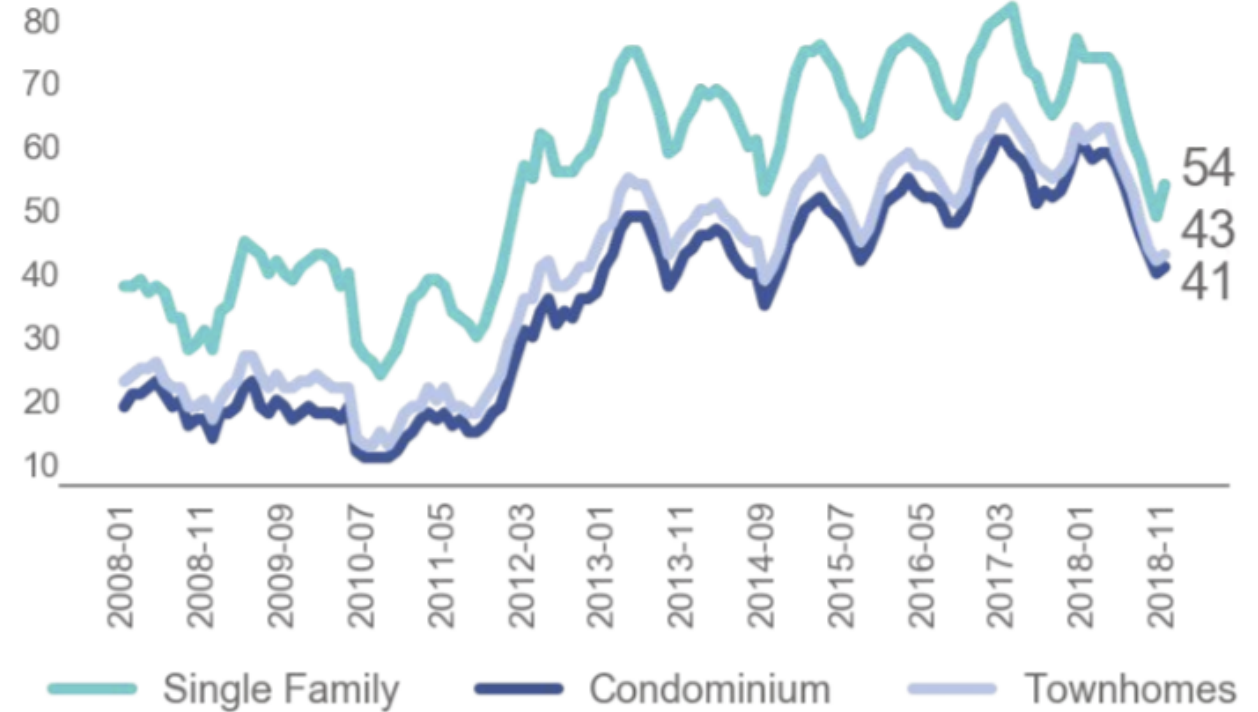
. . . . despite an 5.0% house appreciation rate over previous three years, consumer expectations are dimming

MEDIAN EXPECTED PRICE CHANGE WITHIN THE NEXT 12 MONTHS

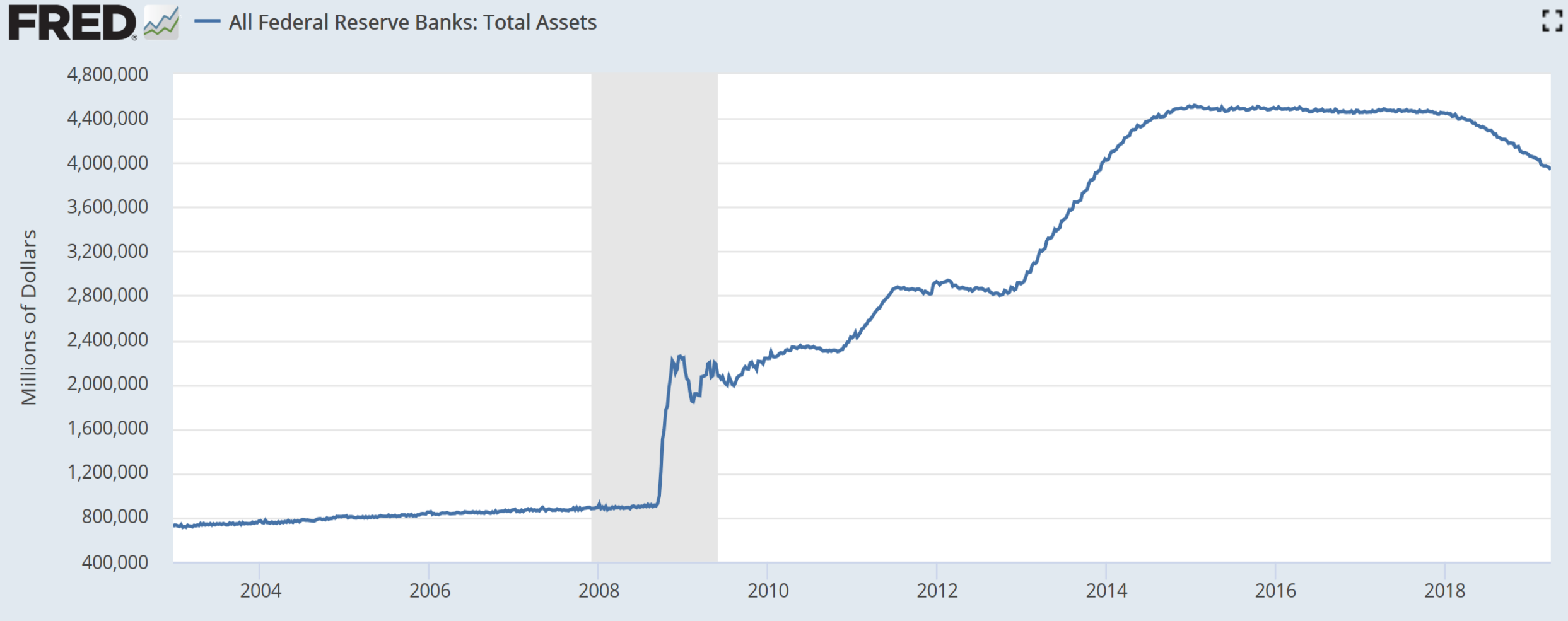
By State, in the Past Three Months



REALTORS® CONFIDENCE INDEX—SIX-MONTH OUTLOOK

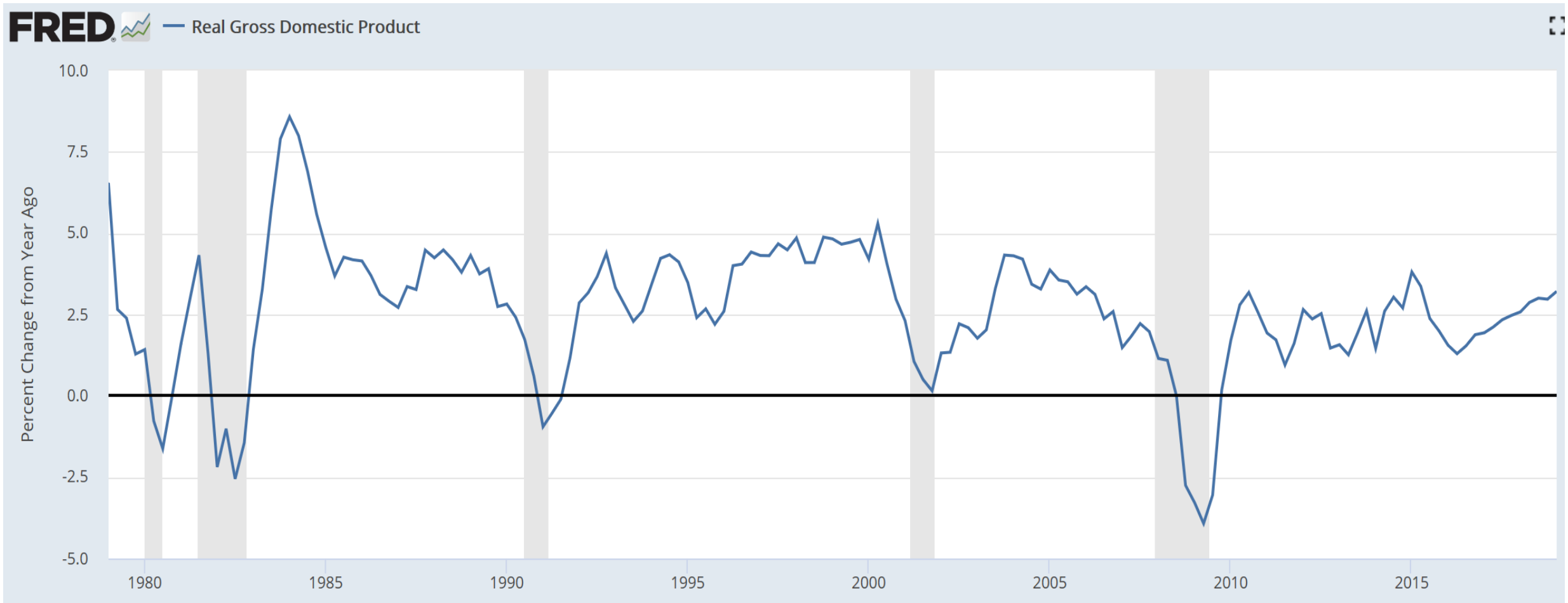


. . . Quantitative Tightening of up to \$50 billion per month will end in September 2019 . . .

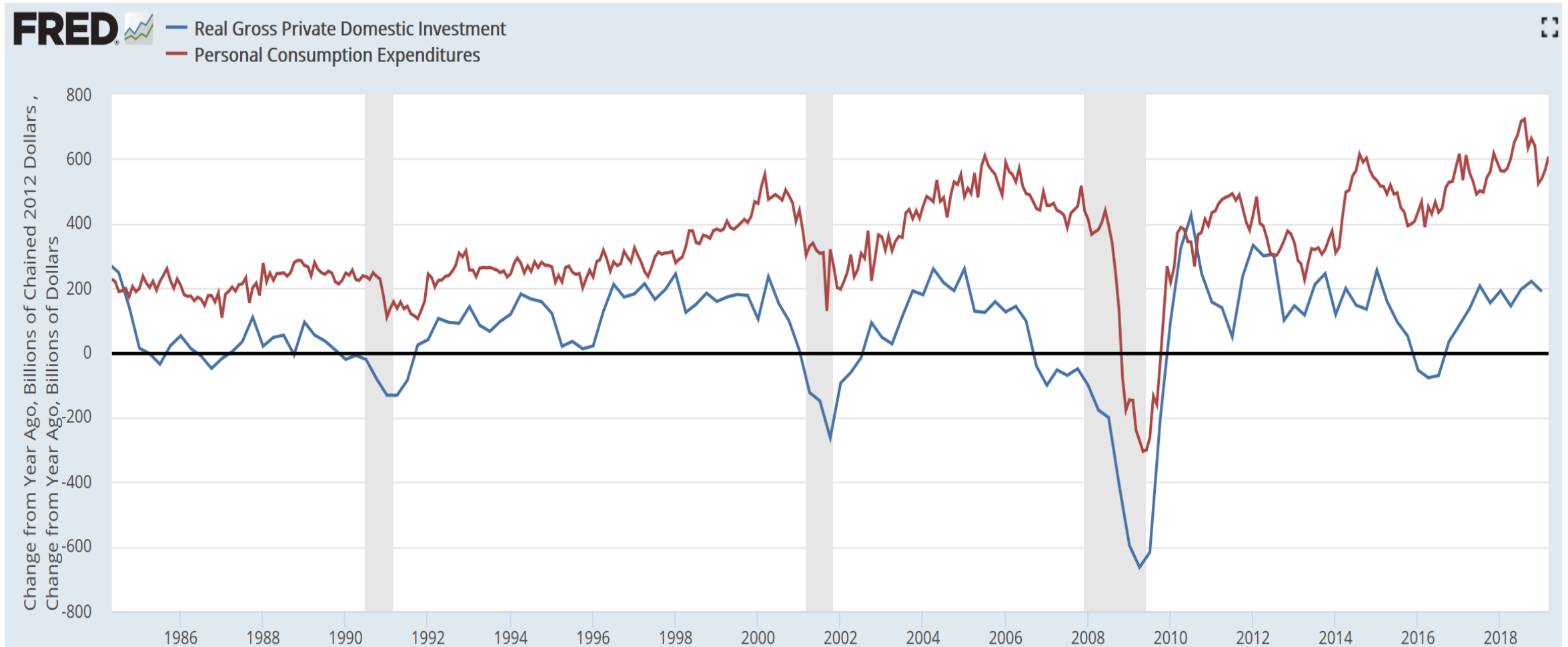


It is the best of times!

2.9% GDP growth in 2018, however 0.55% of the increase is defense (0.21%) and State and Local Government spending (0.34%)

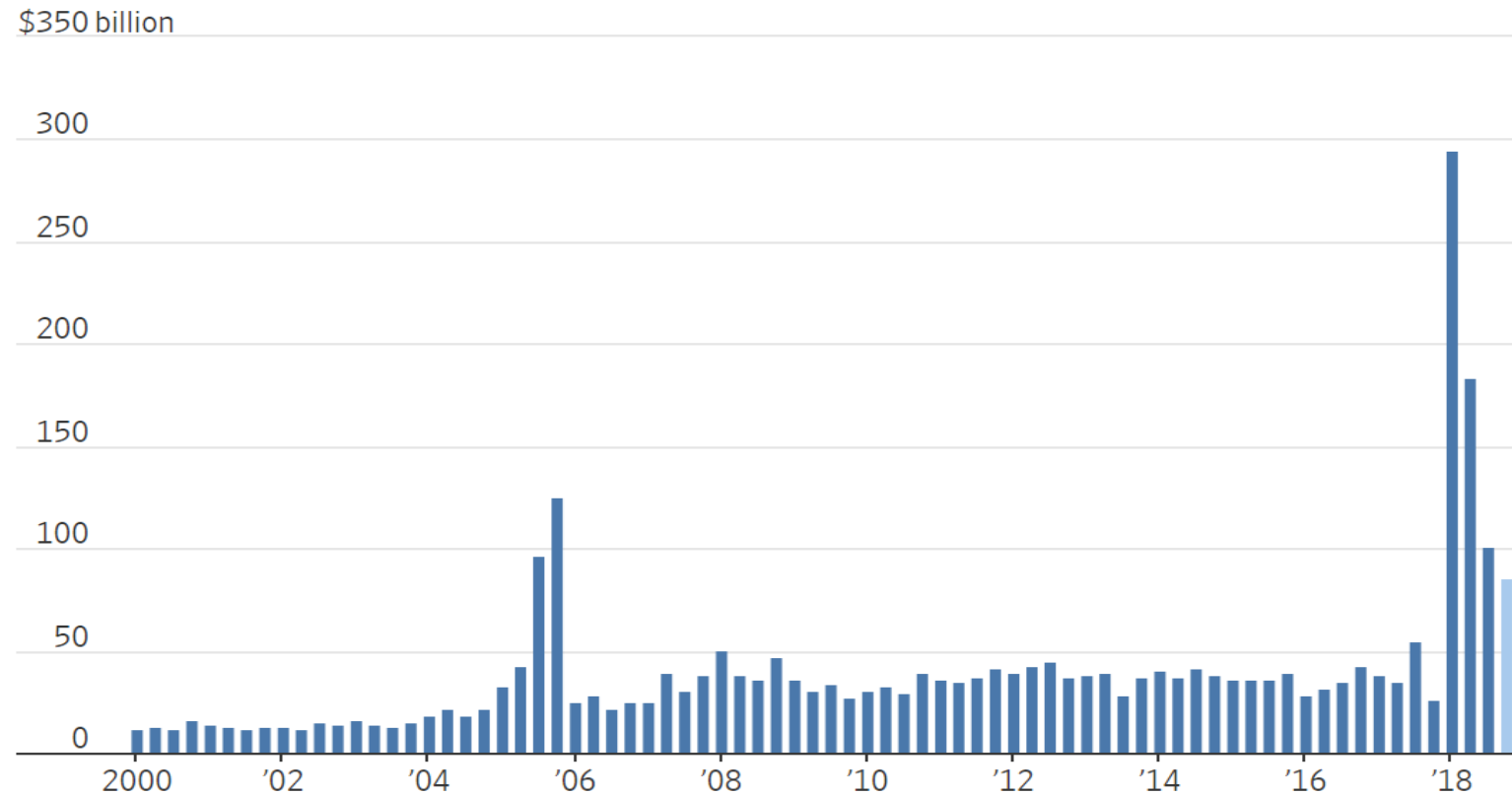


... and consumption and business investment remain strong GDP contributors ...



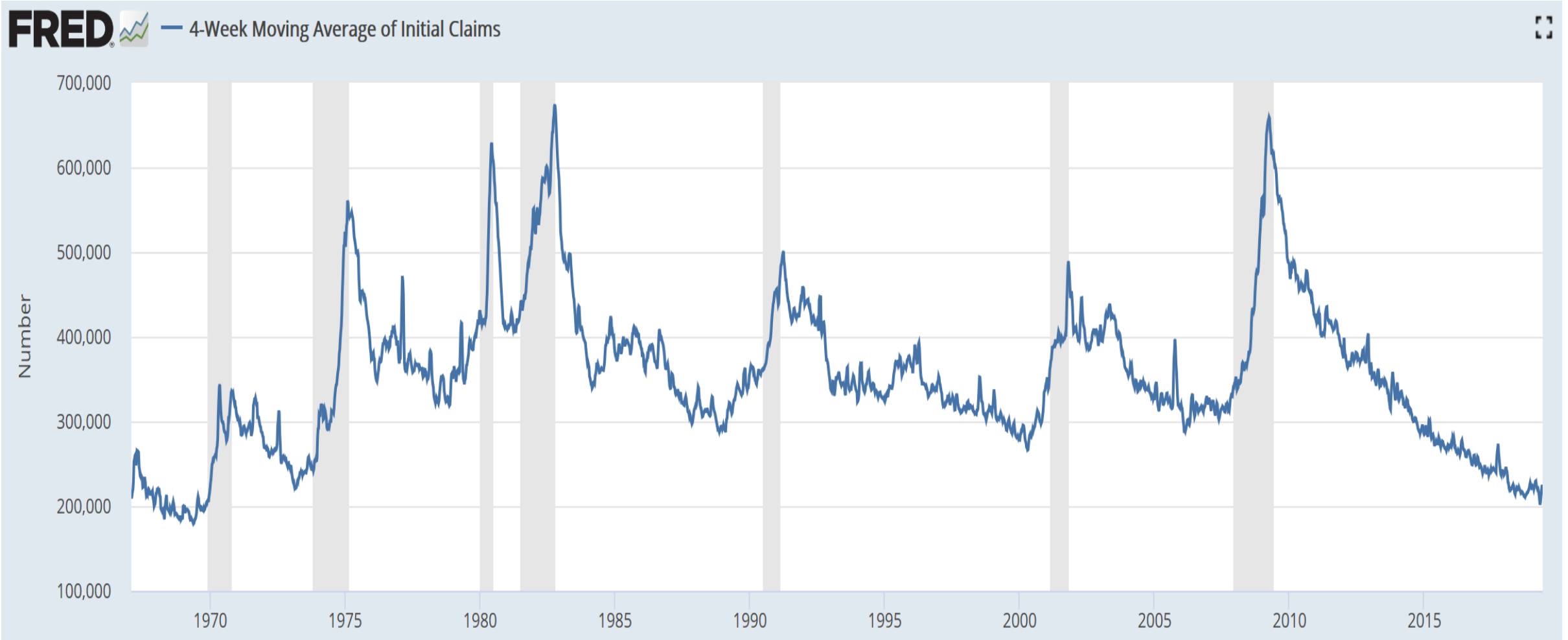
. . . . repatriation of corporate profits from abroad, firms sent back \$664.91 billion in 2018, up from \$155.08 billion in 2017.

Dividends and withdrawals, seasonally adjusted

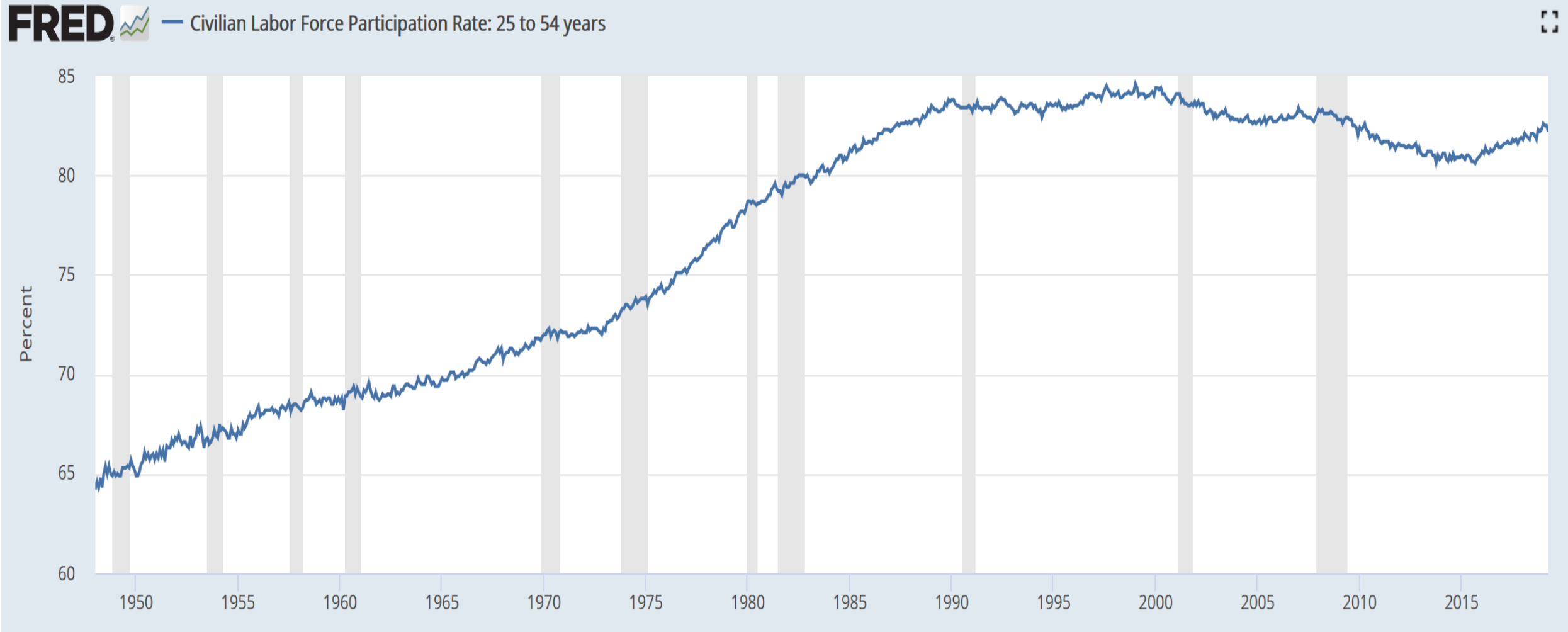


Wages / Employment / Inflation (the concern)

The labor force doubled since 1970, jobless claims remain near all-time lows. . . .

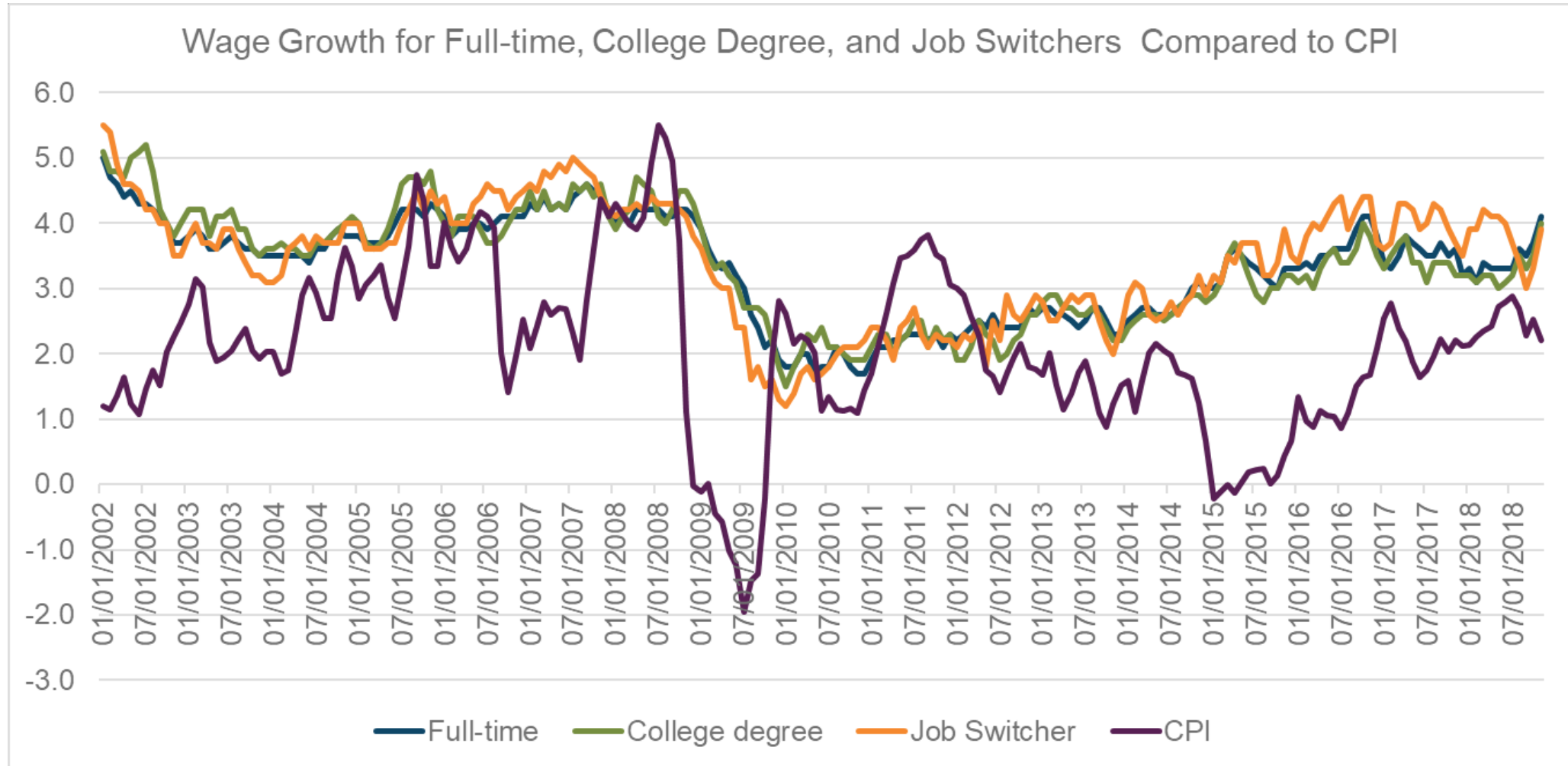


... labor force participation rates are edging up to mid-2000 levels ...



. . . . we have yet to feel the inflationary impacts of trade tariffs

. . . . the Fed is navigating difficult economic waters.



Why do I lean toward Caution?

The downturn will not be wicked and will likely be politically/internationally initiated due to

. . . . the China/U.S. trade relationship and China debt-fueled growth
(from 175% of GDP in 2009 to 300% today)

. . . . Brexit? Italy's weak economy? The EU? What could possibly go wrong?

. . . . U.S. consumer get spooked, import prices/tariffs, market volatility, etc.

. . . . tightening financial markets (wage inflation, quantitative tightening, Fed rate increases).

Why do I lean toward Caution?

Tools to address a downturn are limited:

Federal Reserve – typical Fed rate cuts, 5% in a recession – has only 2.5 points today

-- Fed has a \$3.9 trillion on balance sheet from Quantitative Easing

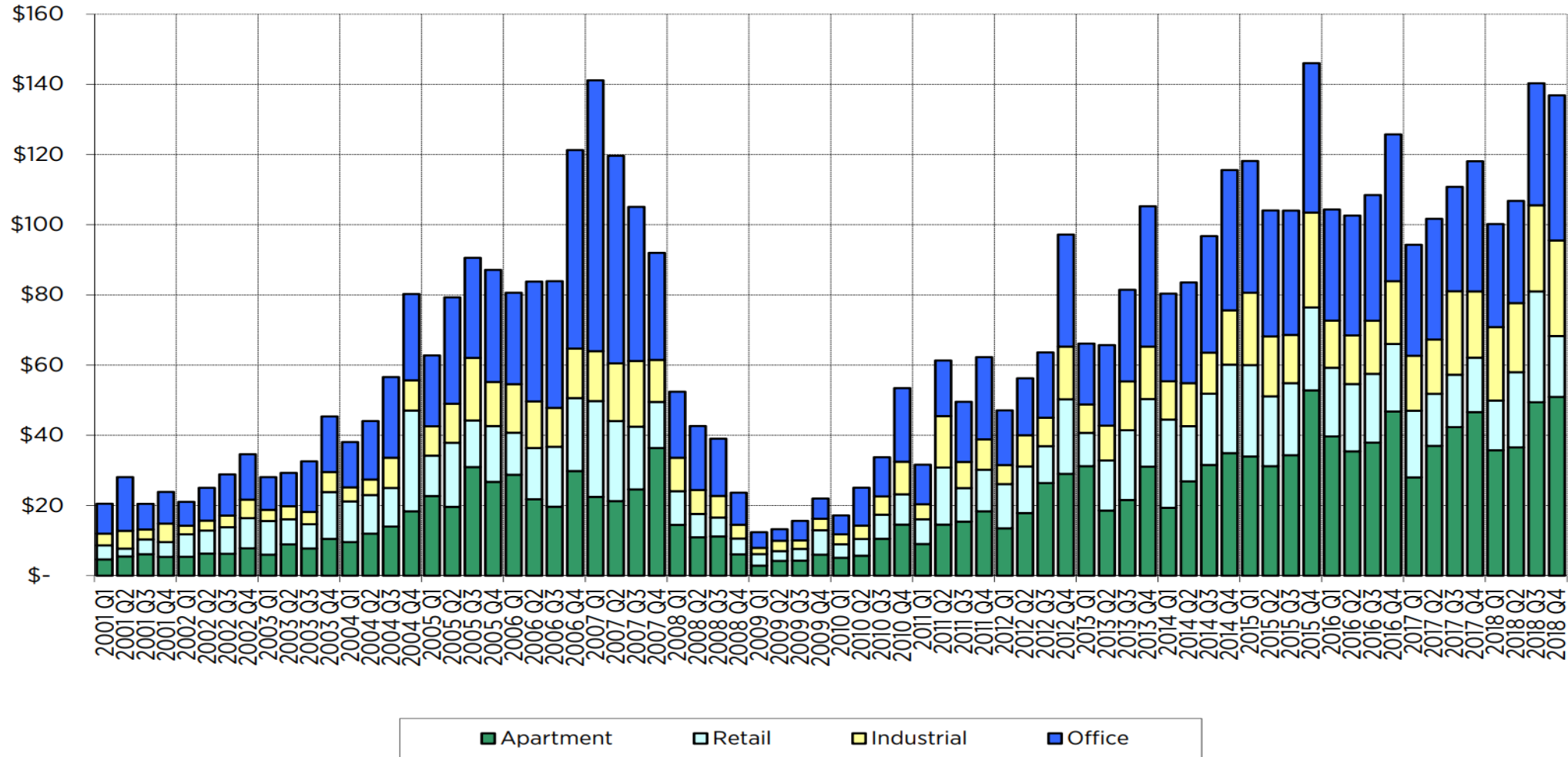
Fiscal Stimulus -- Federal deficit was 3.9% of GDP in 2018, will be 4.6% in 2019

Real Estate Equity Capital Markets

Commercial real estate transaction volume remains stable/robust

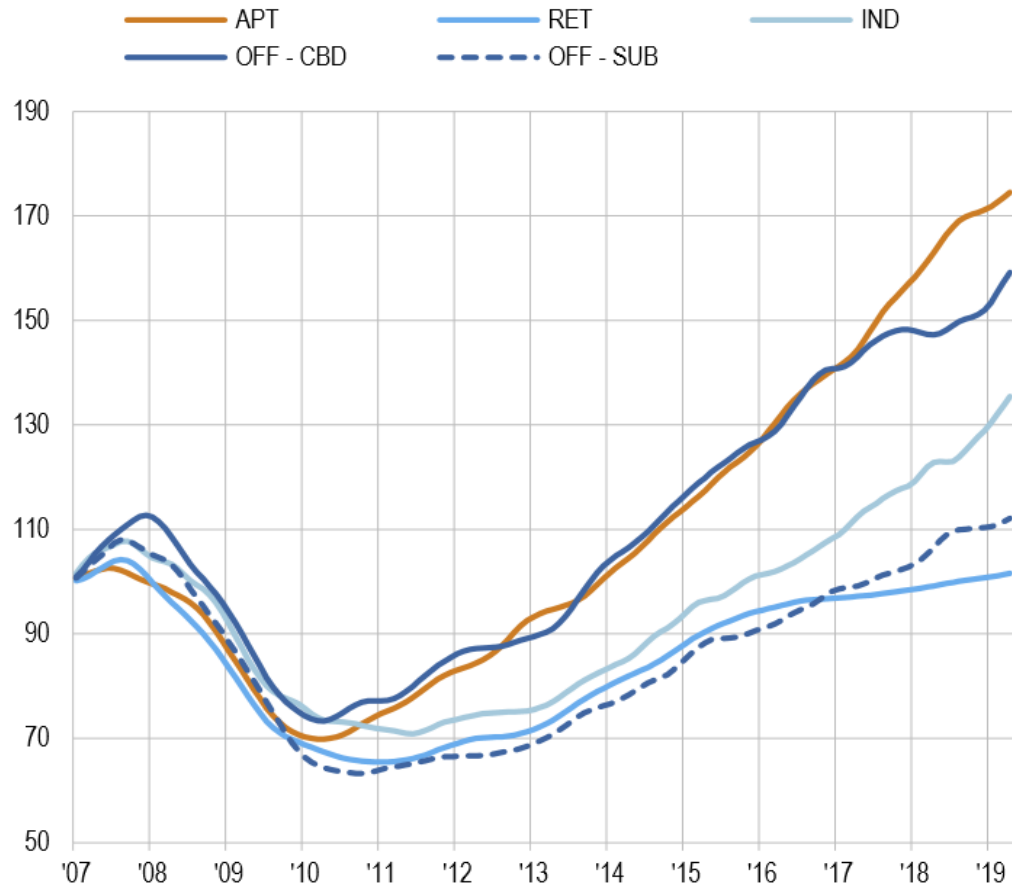
QUARTERLY SALES OF LARGER (\$2.5 MILLION+) COMMERCIAL/MULTIFAMILY PROPERTIES

Billions of dollars. Properties and portfolios \$2.5 million and greater

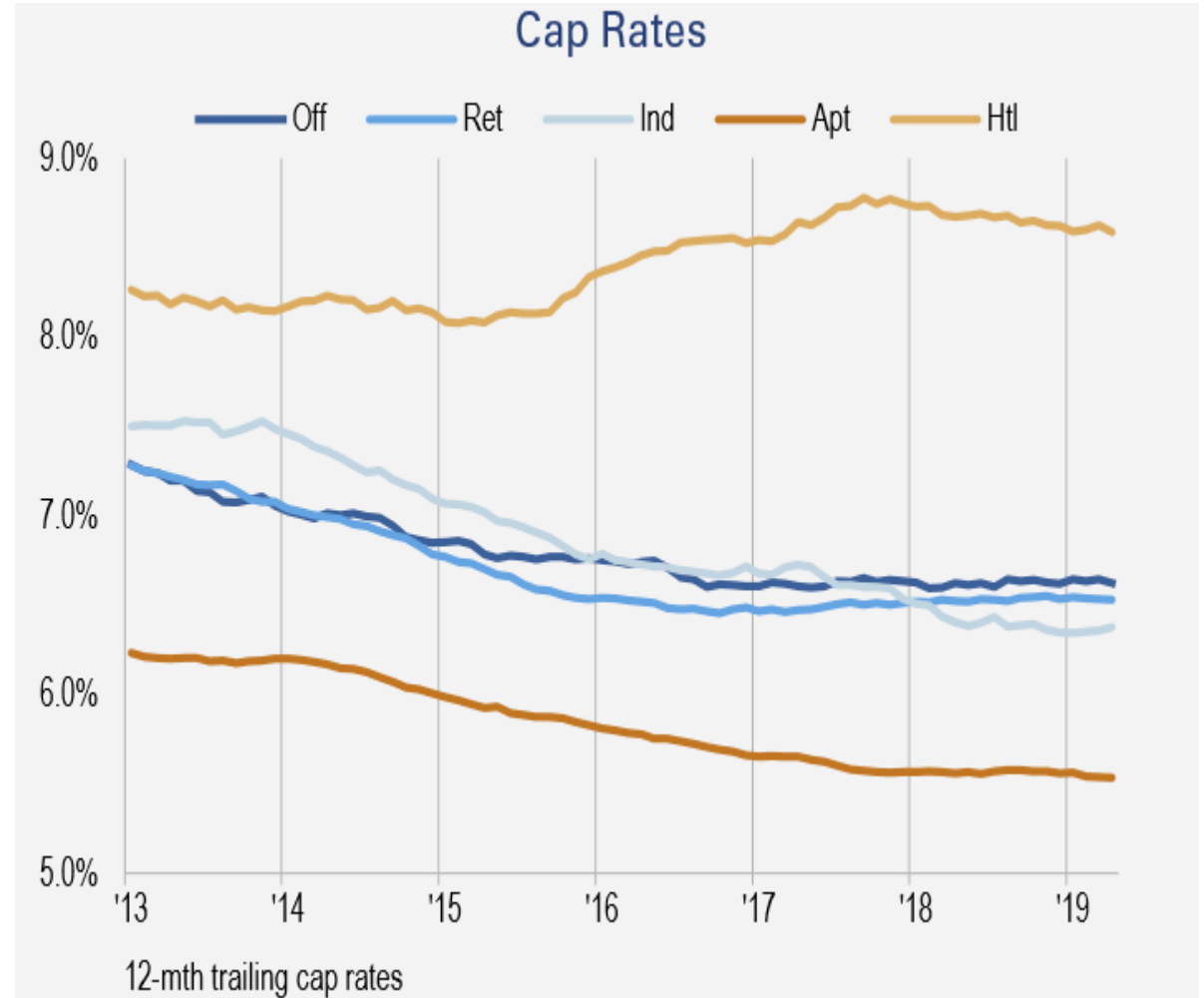


. . . . RCA prices and cap rates across property types

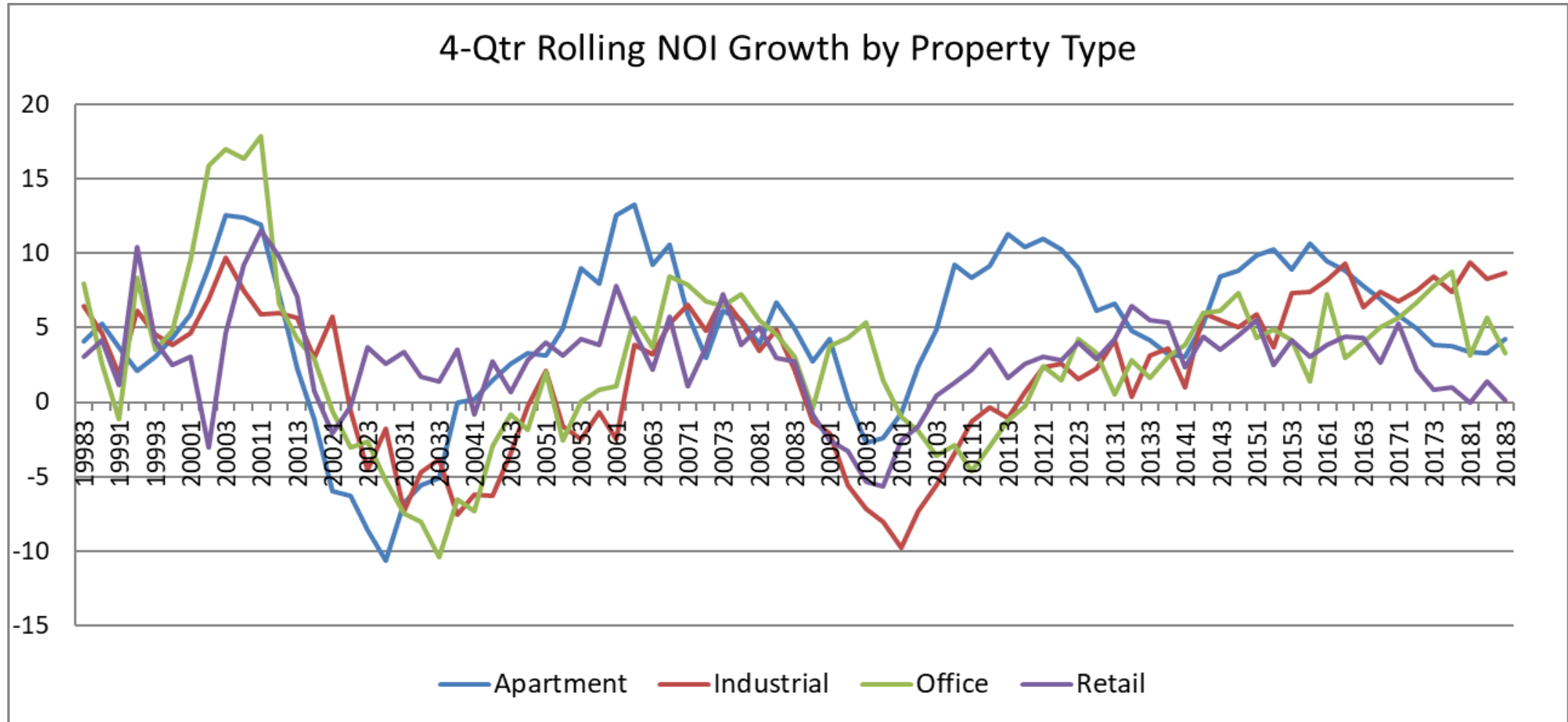
National Property Types



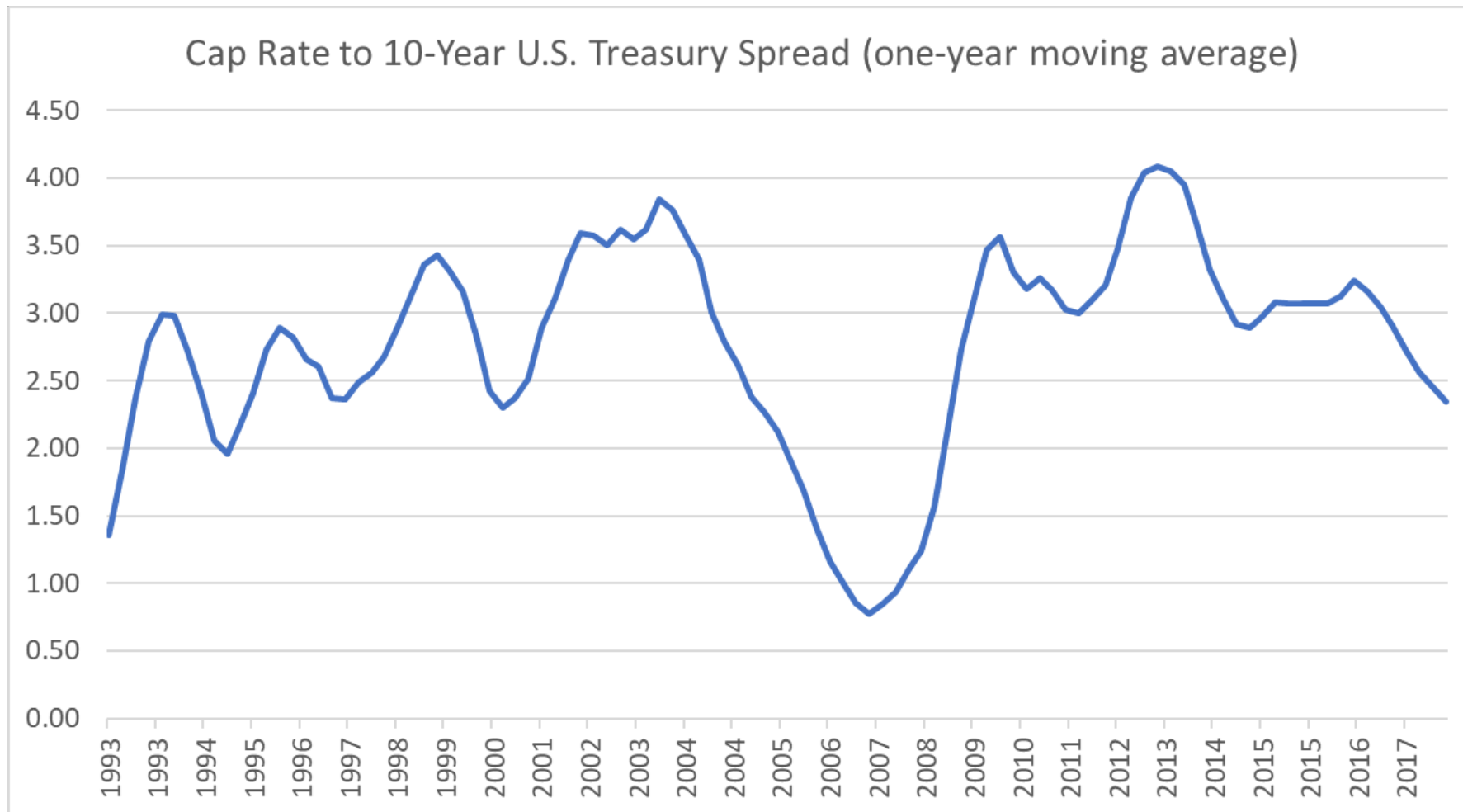
Cap Rates



. . . . property income growth remains robust, sans retail

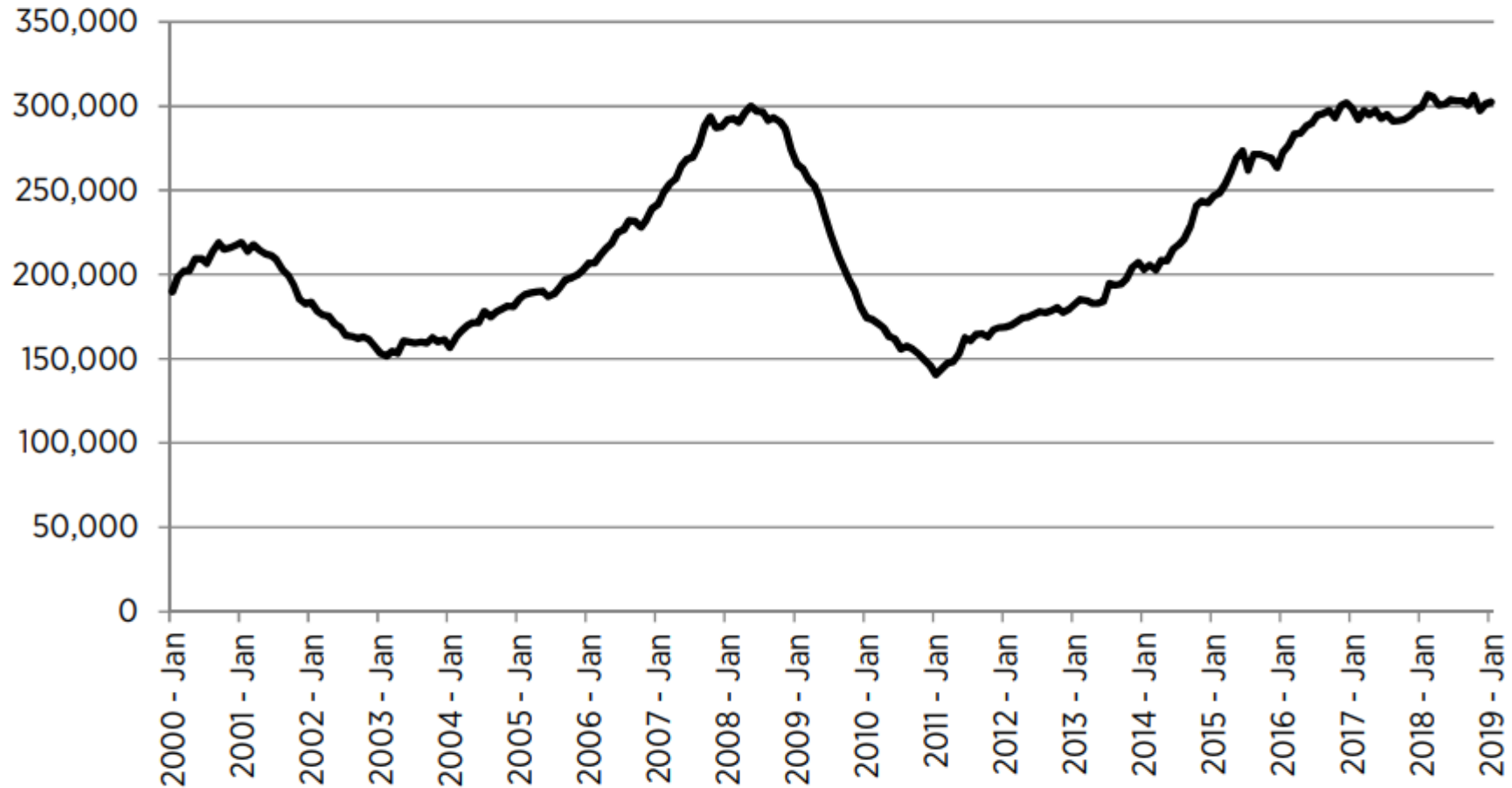


. . . . real estate risk spreads are rangebound



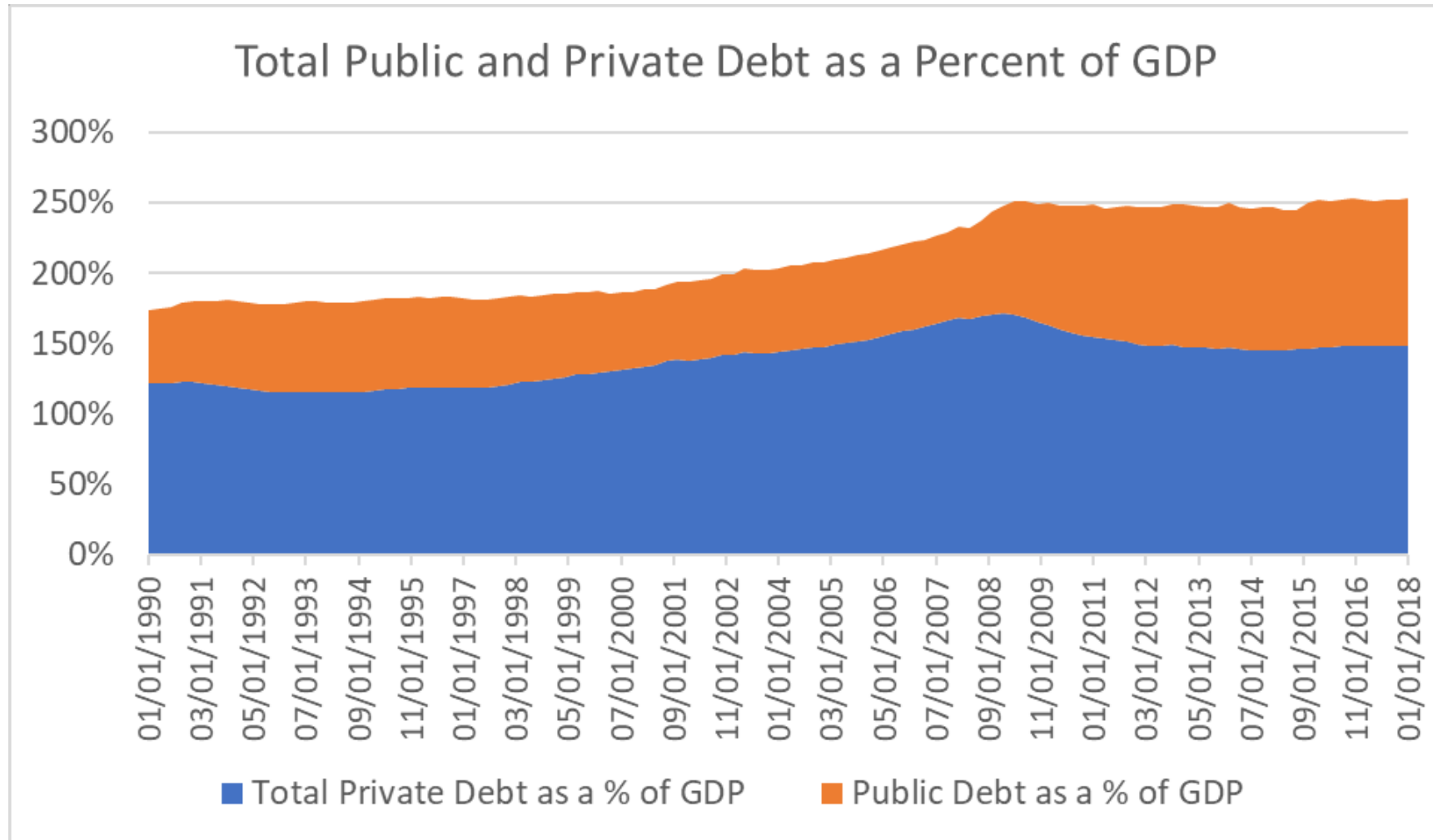
. . . . construction volumes are stable

Value of Selected Private CRE-Related Construction Put-In-Place, \$millions

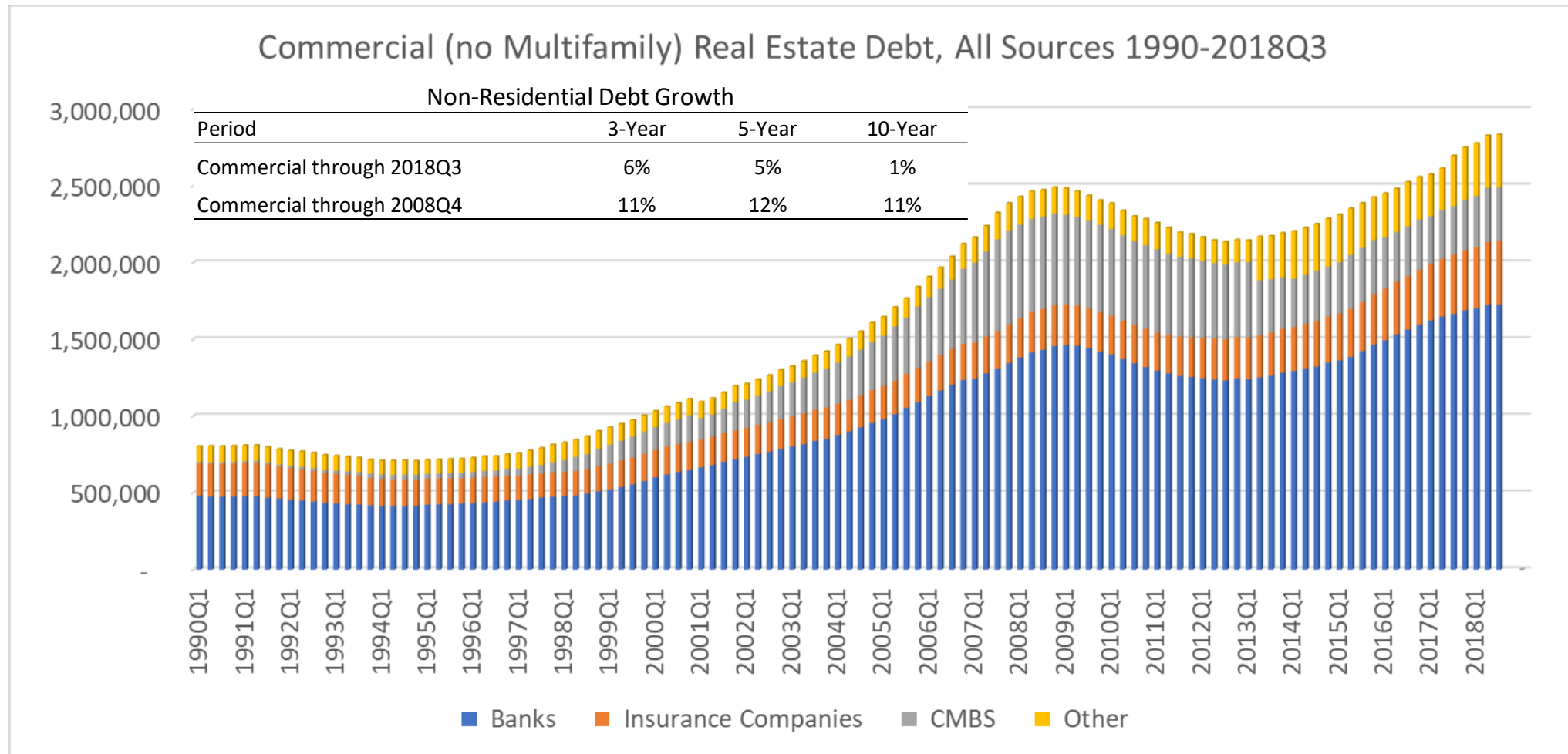


Real Estate Debt Capital Markets

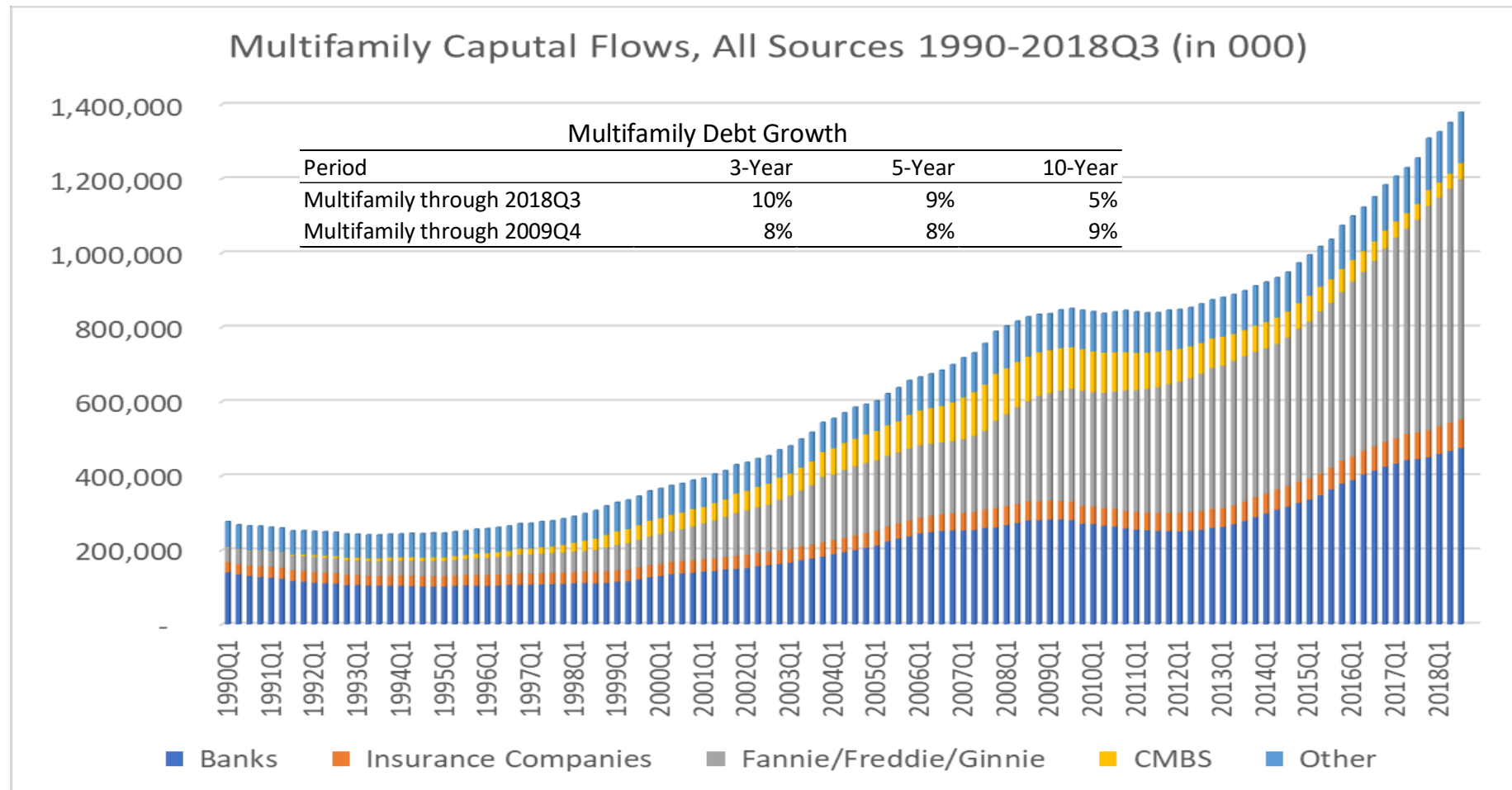
Private debt as a percent of GDP has fallen from 171% in 2009 to 148% today



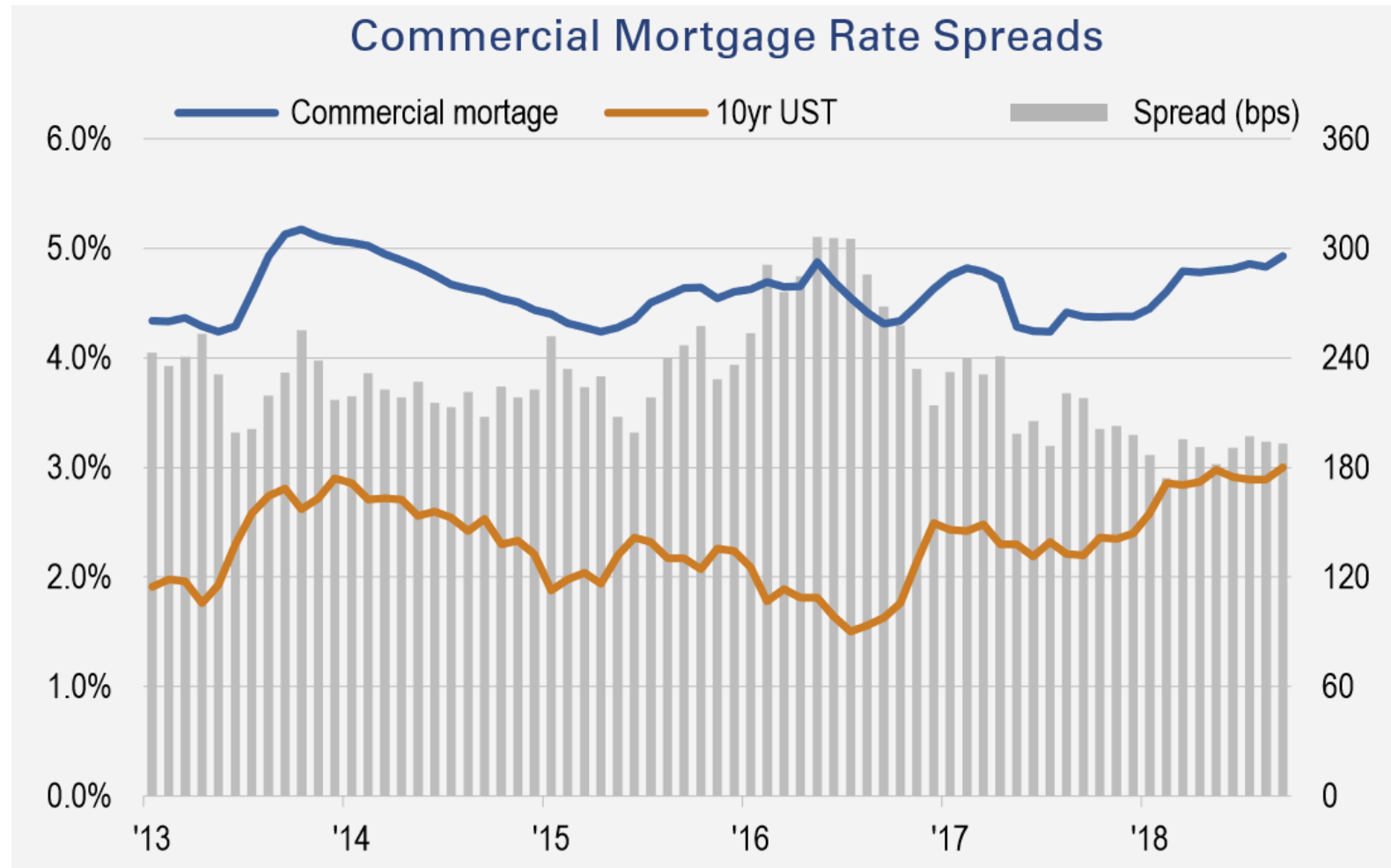
. . . . commercial real estate debt outstanding has grown over the last several years



. . . multifamily debt is growing at an unsustainable pace (maybe)

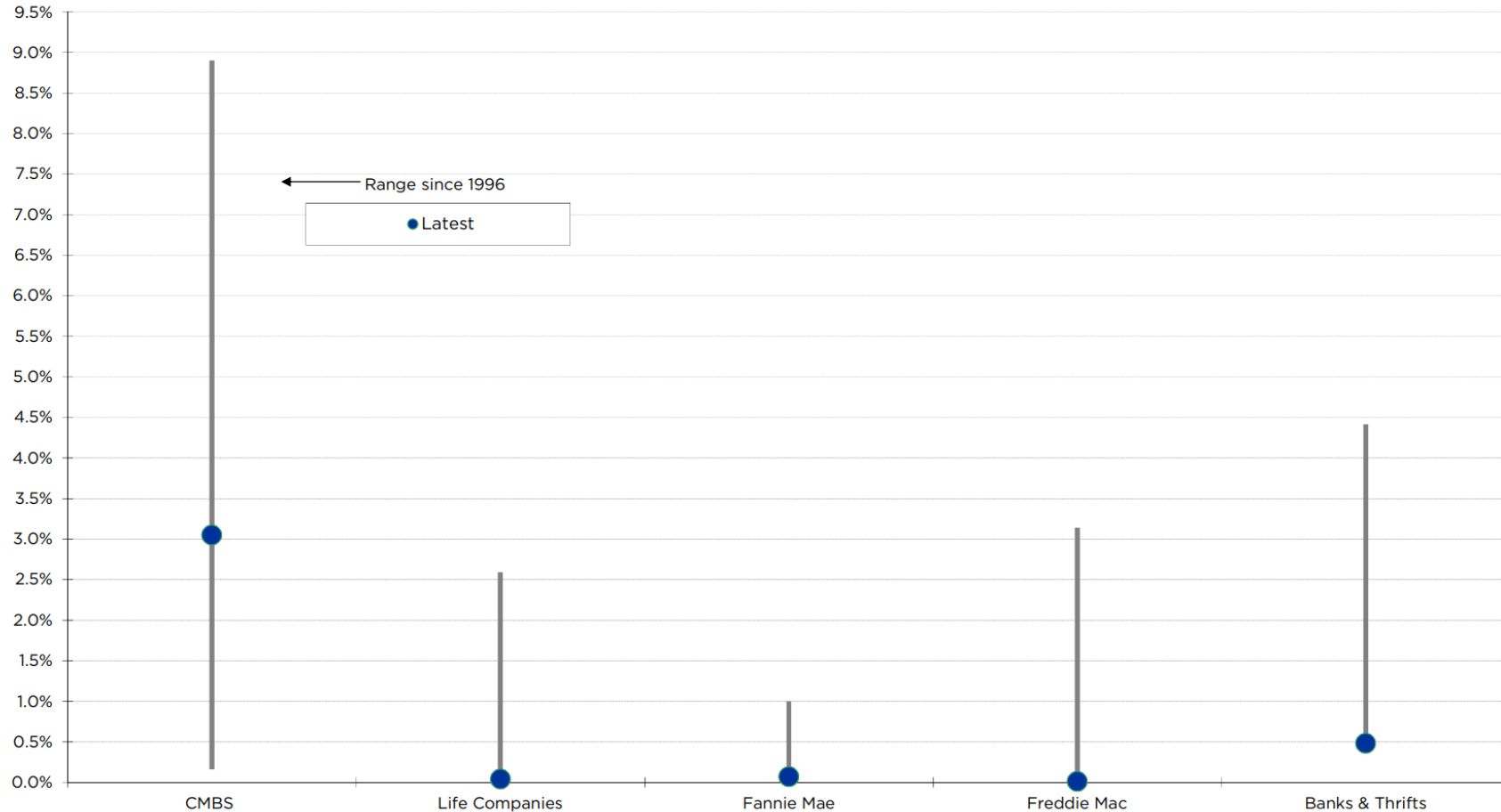


... competition for debt has kept commercial mortgage spreads tight ...



. . . . delinquency rates are at or near 20-year lows for all but CMBS

Delinquency Rate Range 1996-2018 for Select Real Estate Lenders



Real Estate Debt and Equity Markets

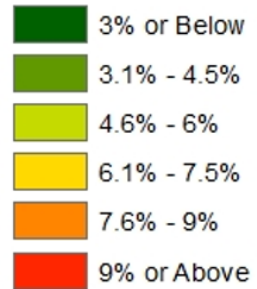
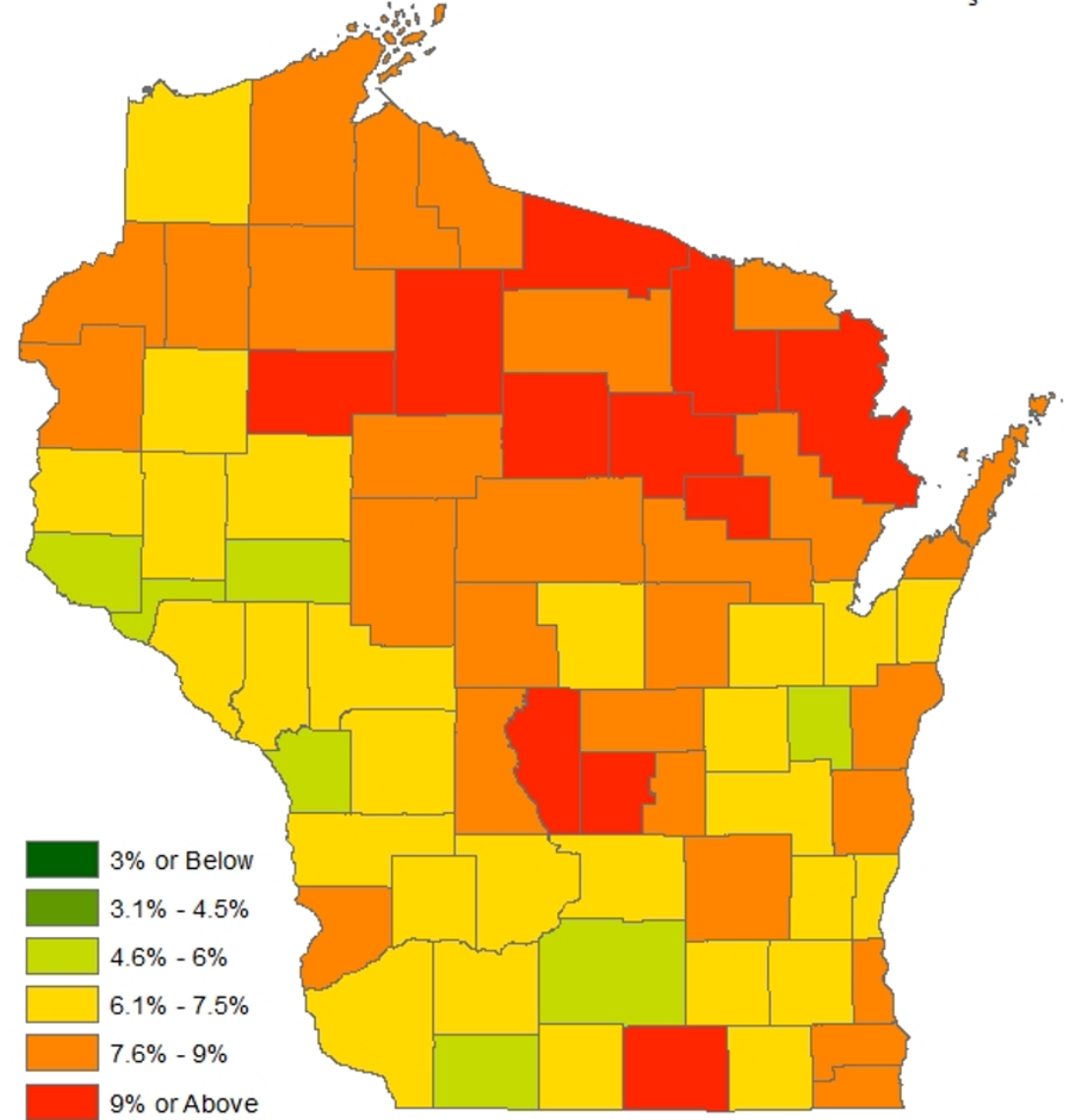
Real estate is fully priced relative to other asset classes

There is no shortage of equity capital, but equity investment is yield constrained and maintaining discipline at current cap rates

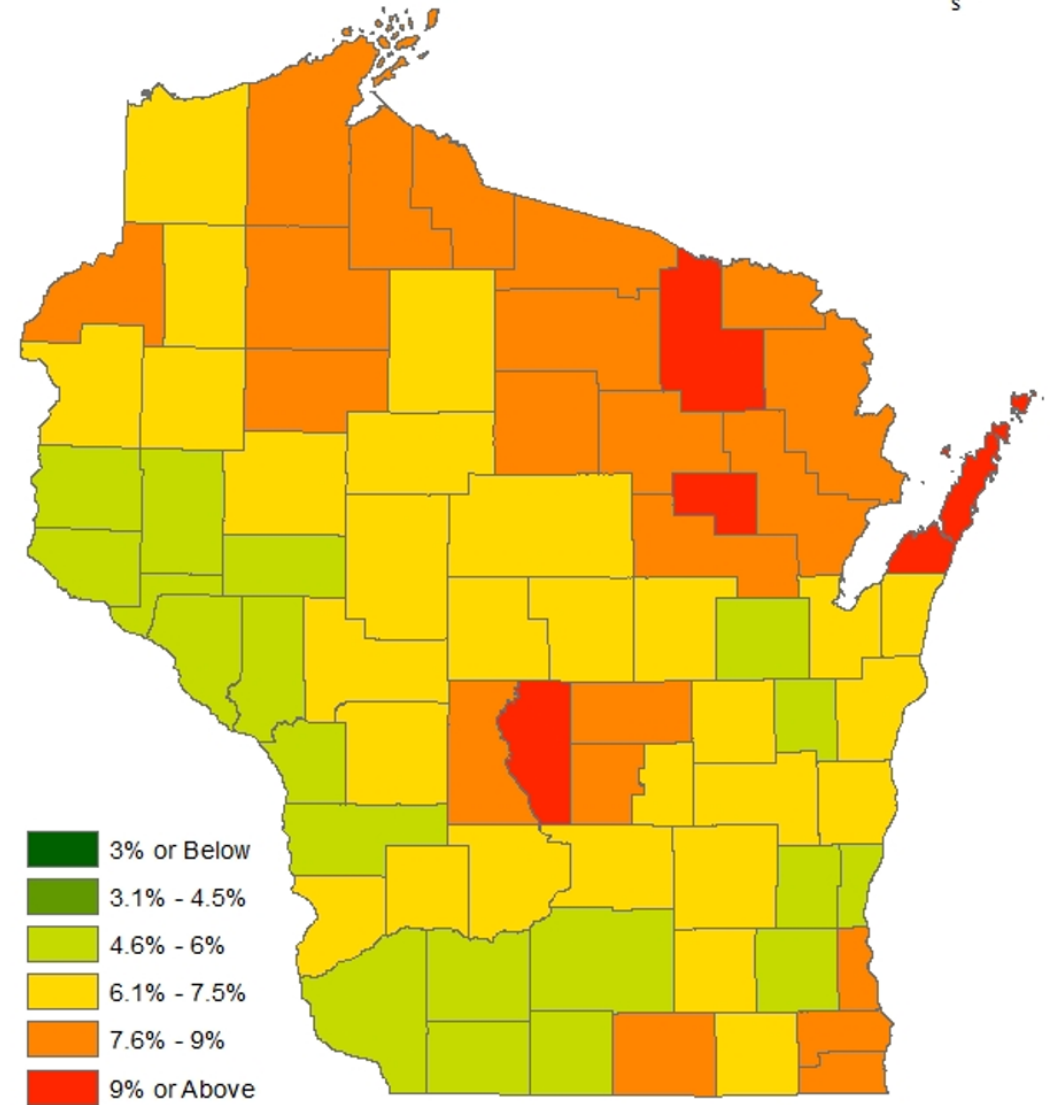
The debt markets are awash in capital with leveraged loan funds pushing traditional bank lenders, 2019Q1 reveals some bank lending retreat

Wisconsin Data

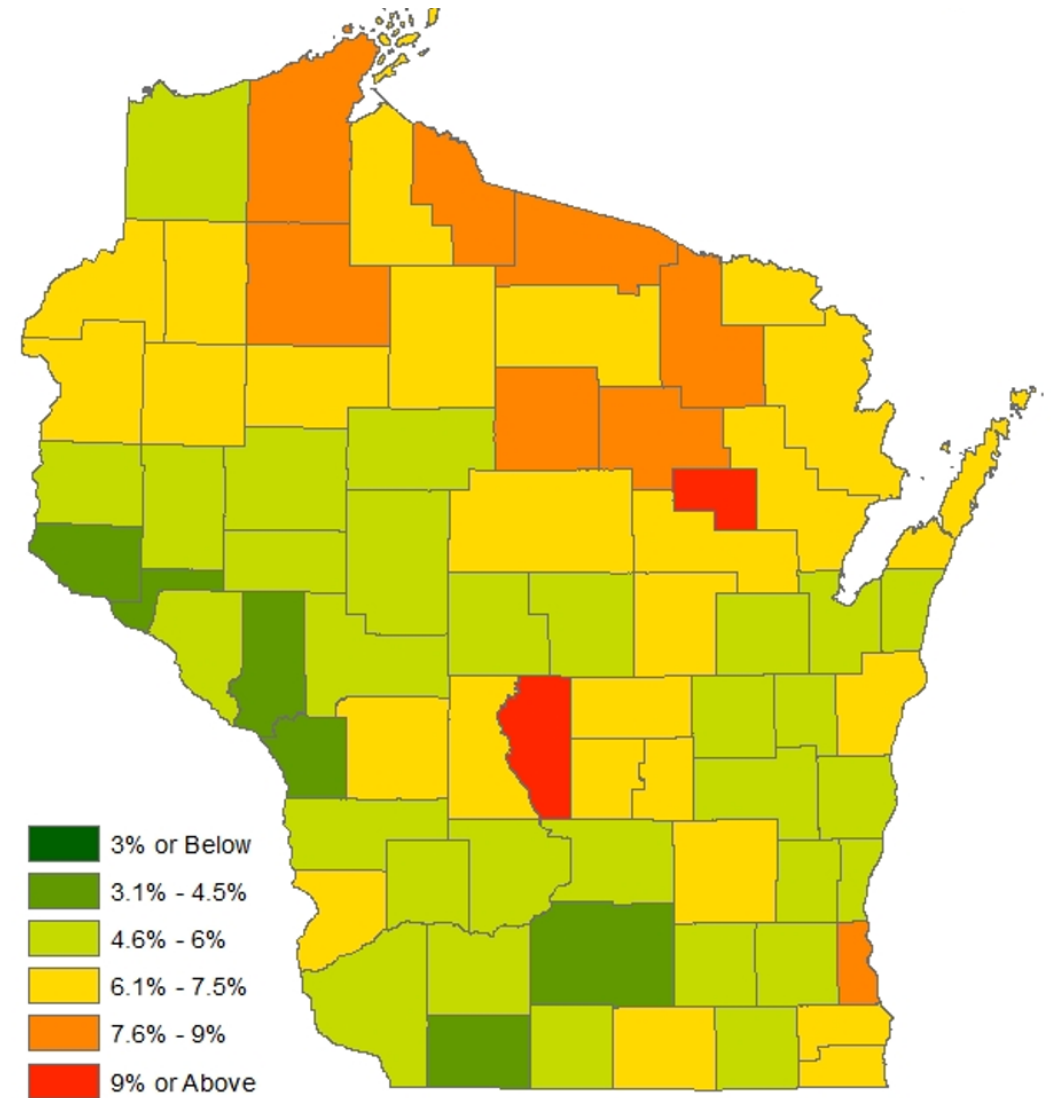
Wisconsin, the economic recovery 2010 in unemployment rates



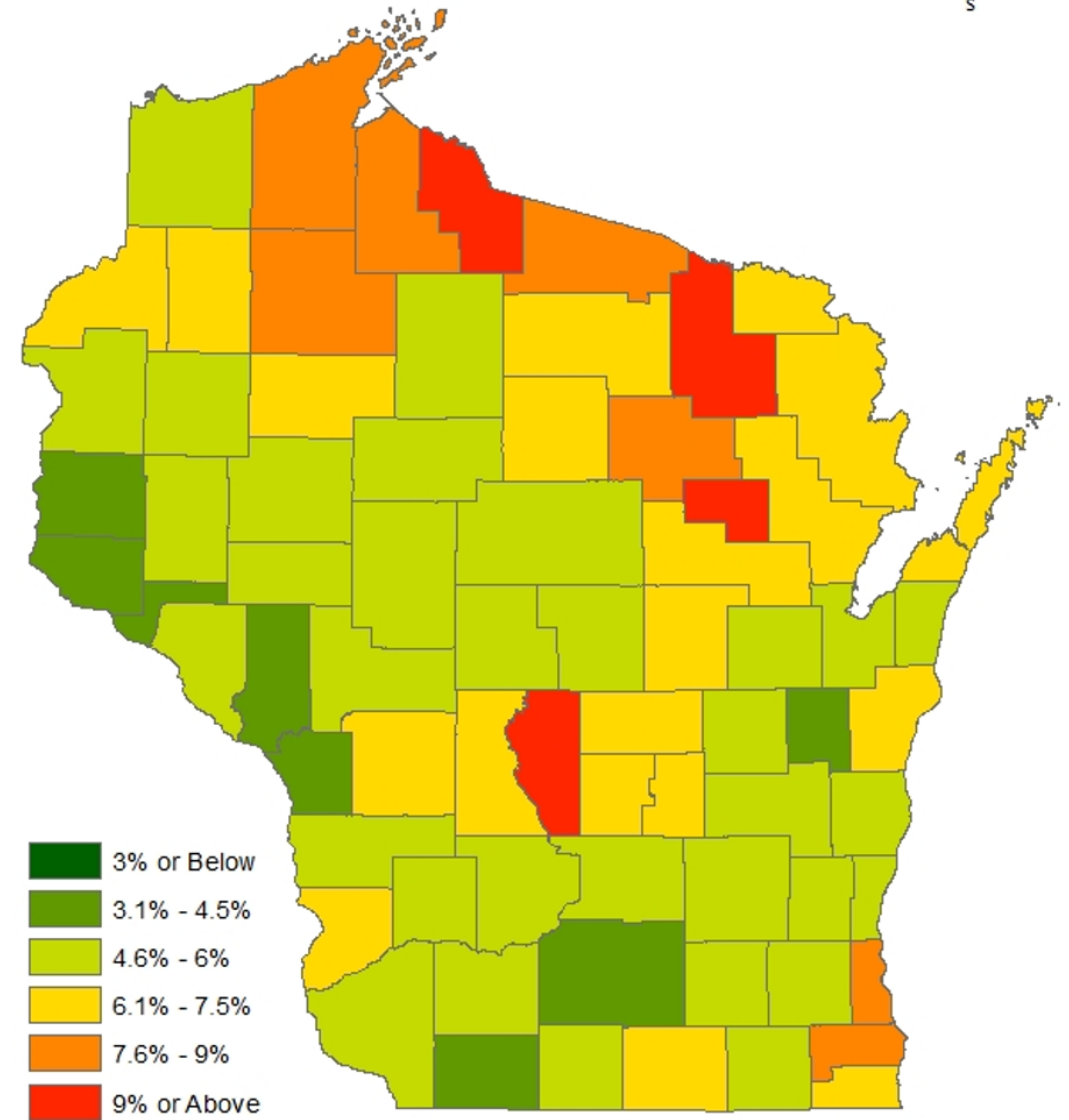
. . . . Wisconsin, the economic recovery 2011 in unemployment rates. . . .



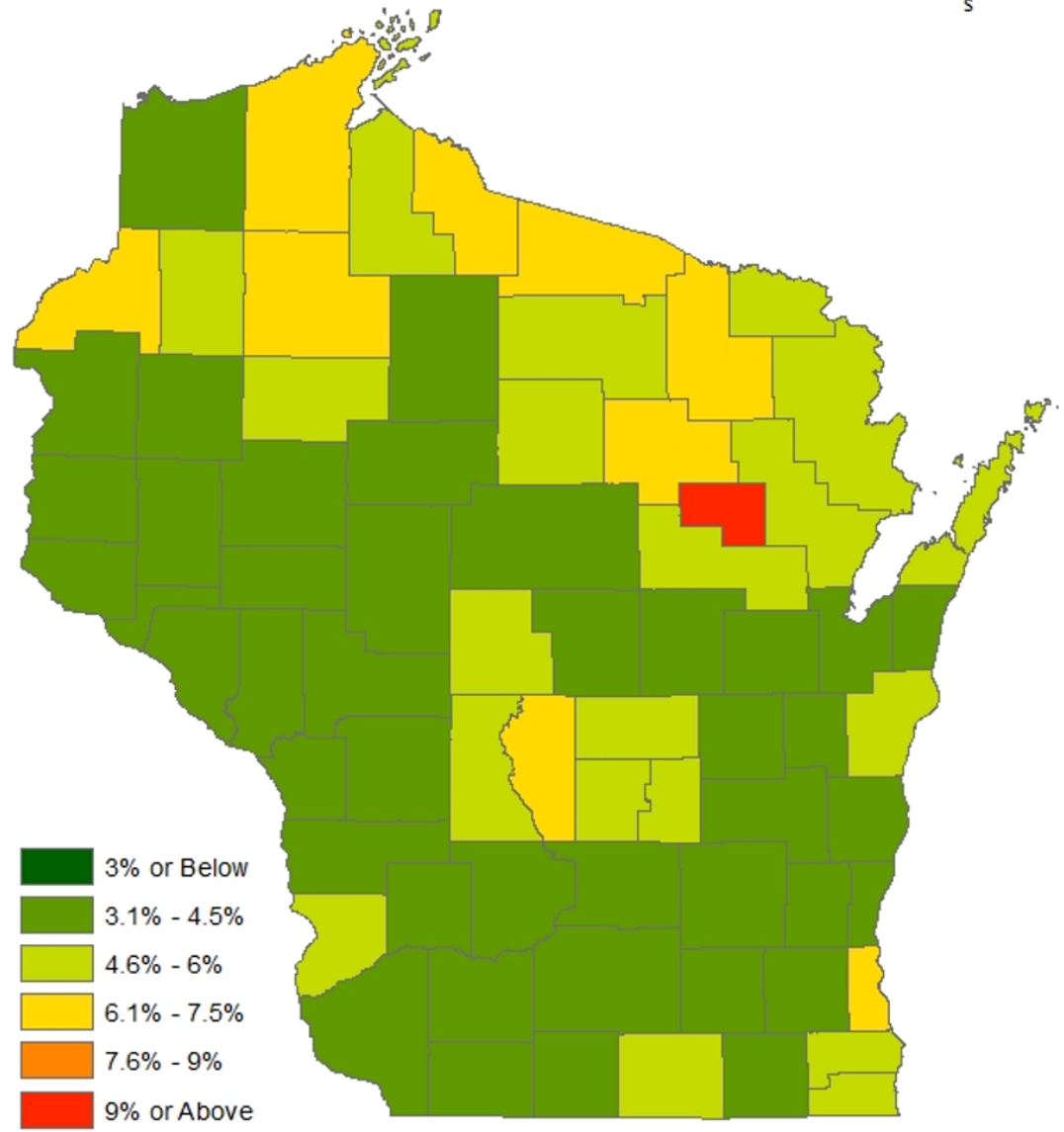
. . . . Wisconsin, the economic recovery 2012 in unemployment rates



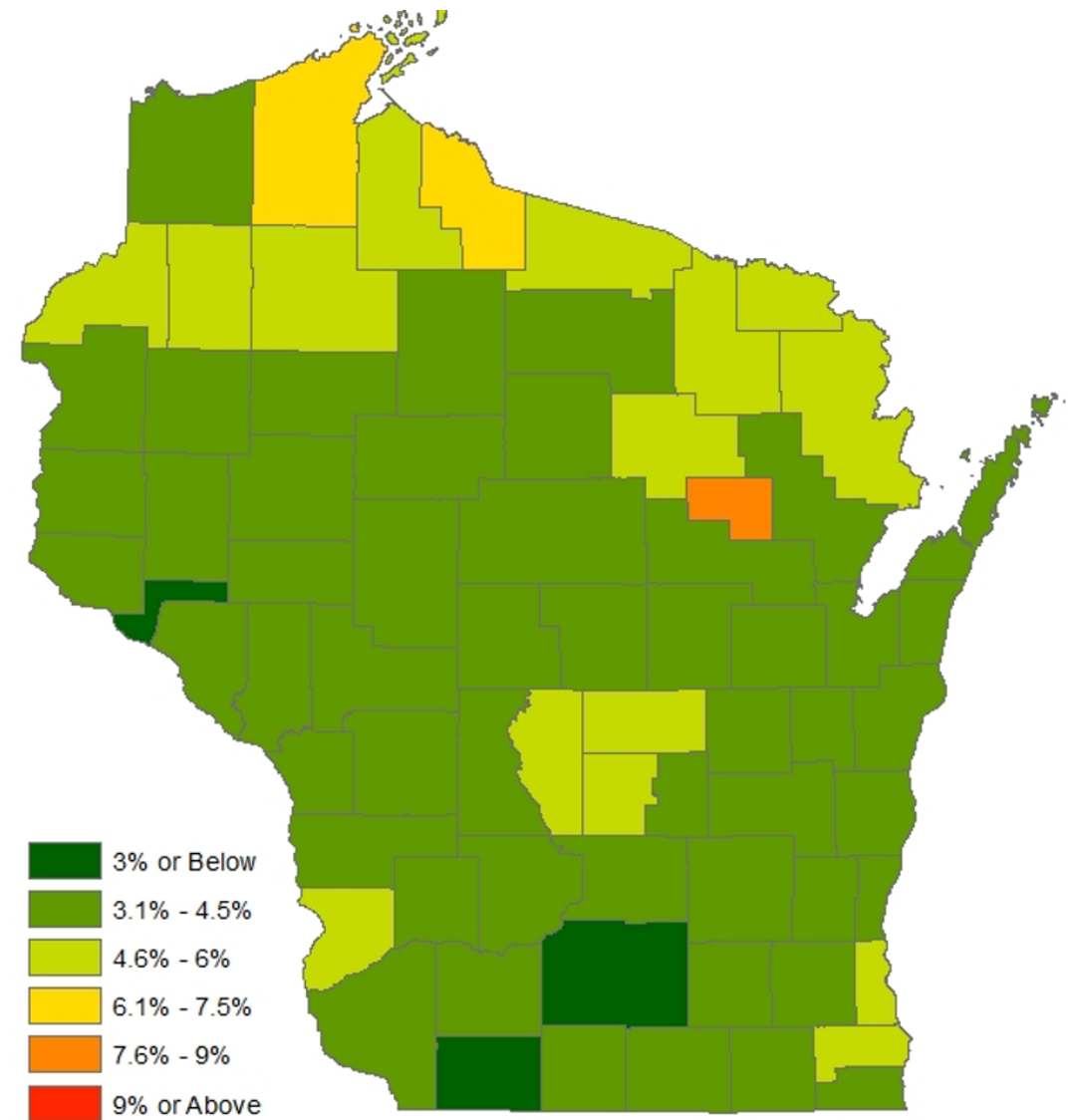
. . . . Wisconsin, the economic recovery 2013
in unemployment rates. . . .



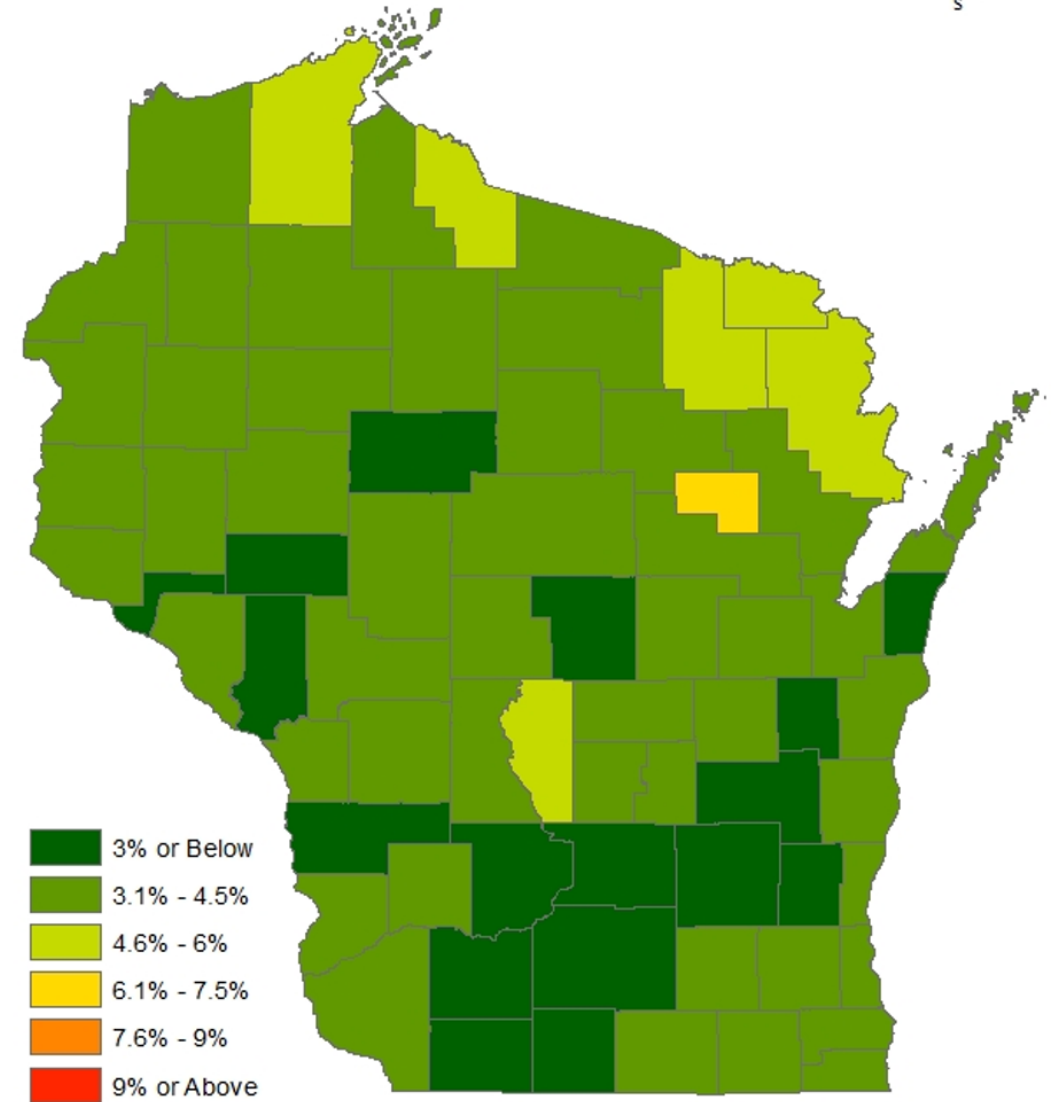
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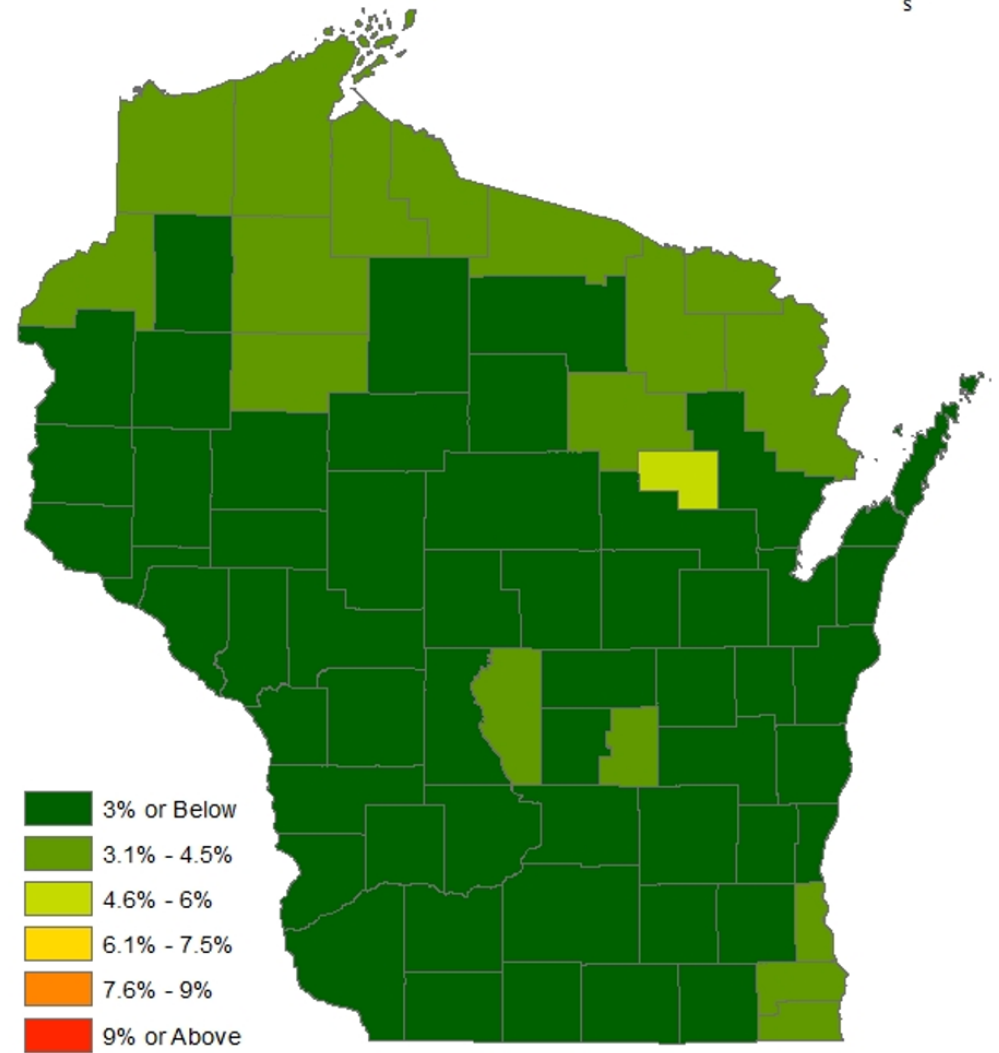
. . . . Wisconsin, the economic recovery 2015 in unemployment rates. . . .



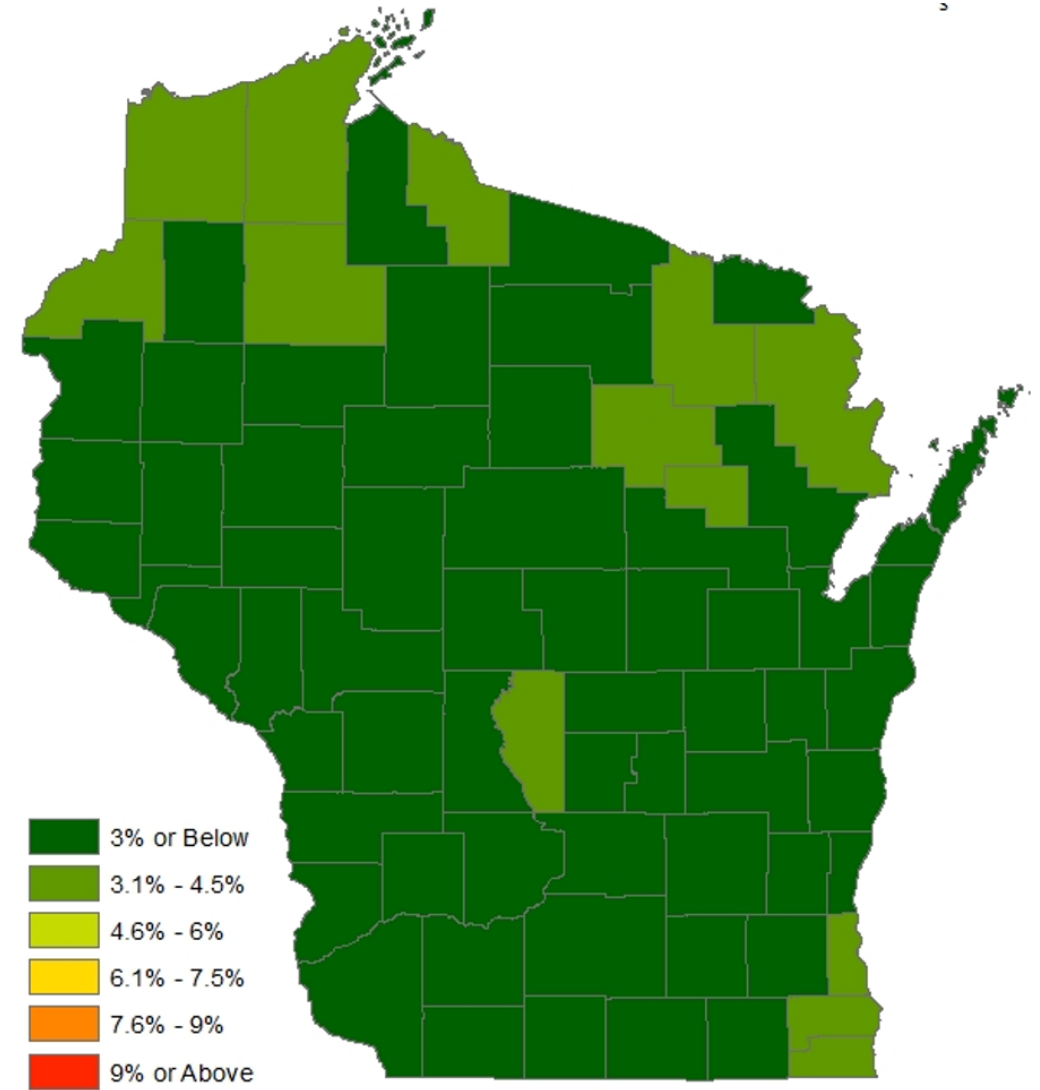
.... Wisconsin, the economic recovery 2016 in unemployment rates



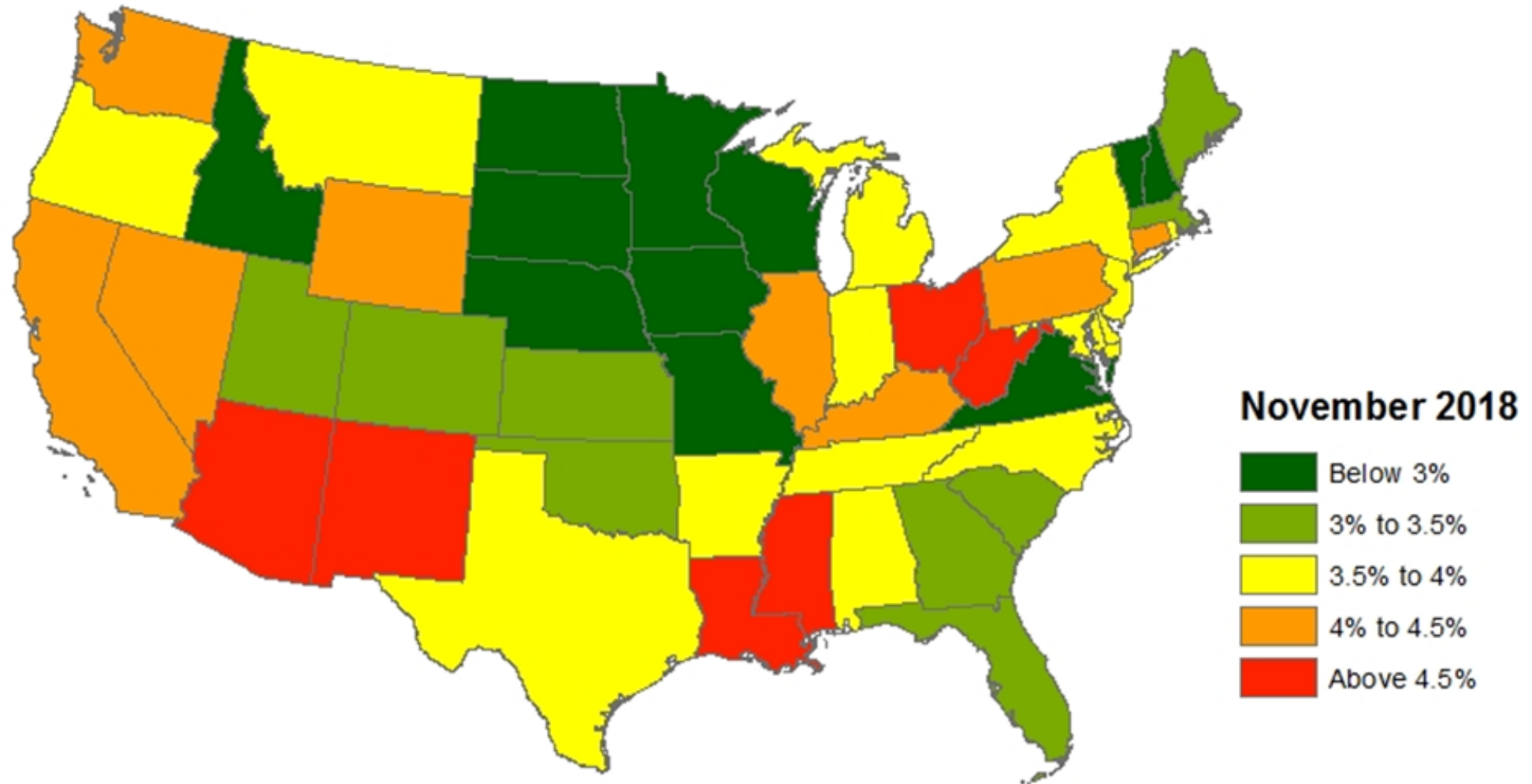
. . . . Wisconsin, the economic recovery 2017 in unemployment rates



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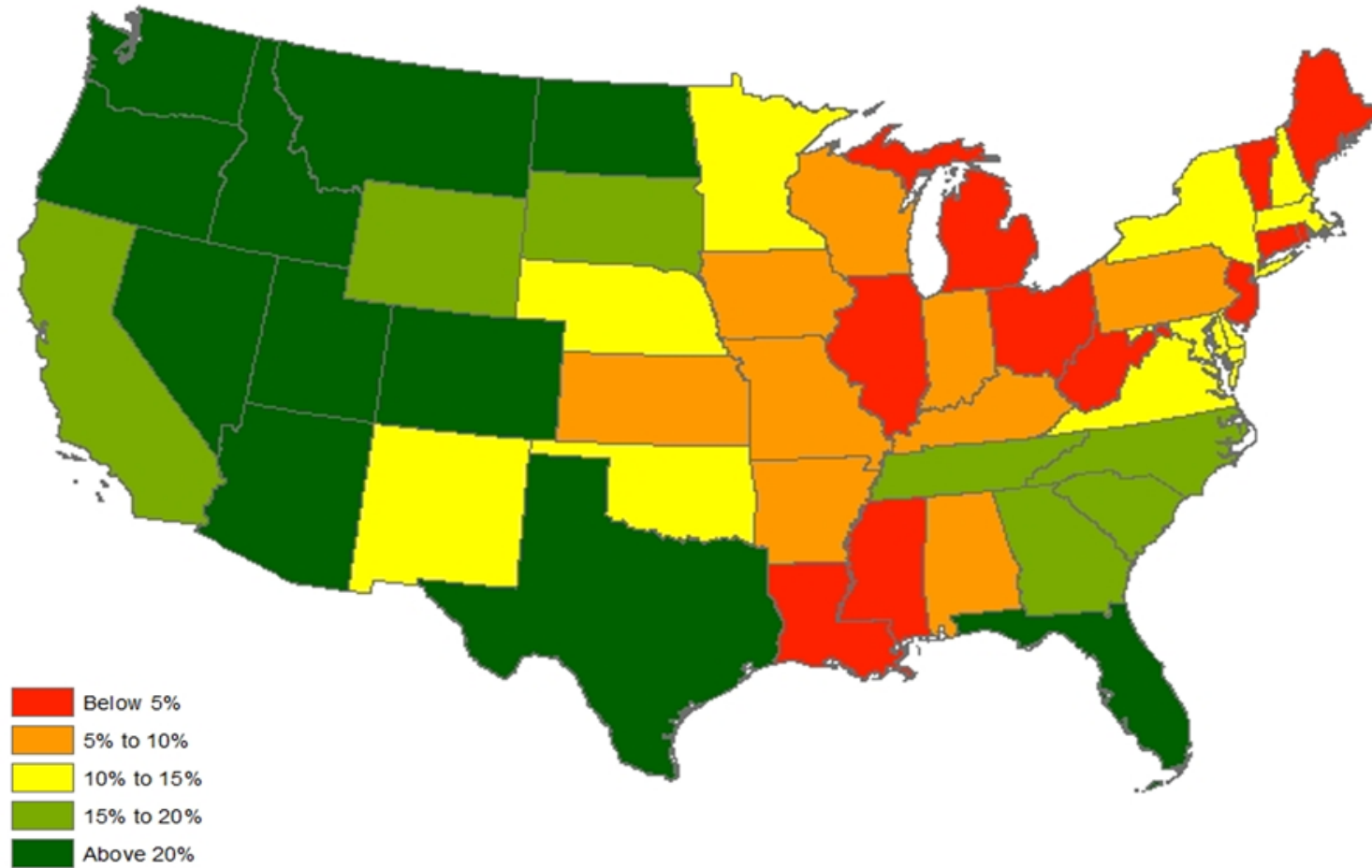


Unemployment rates in the United States. . . .



. . . . Wisconsin's growth in employment has lagged

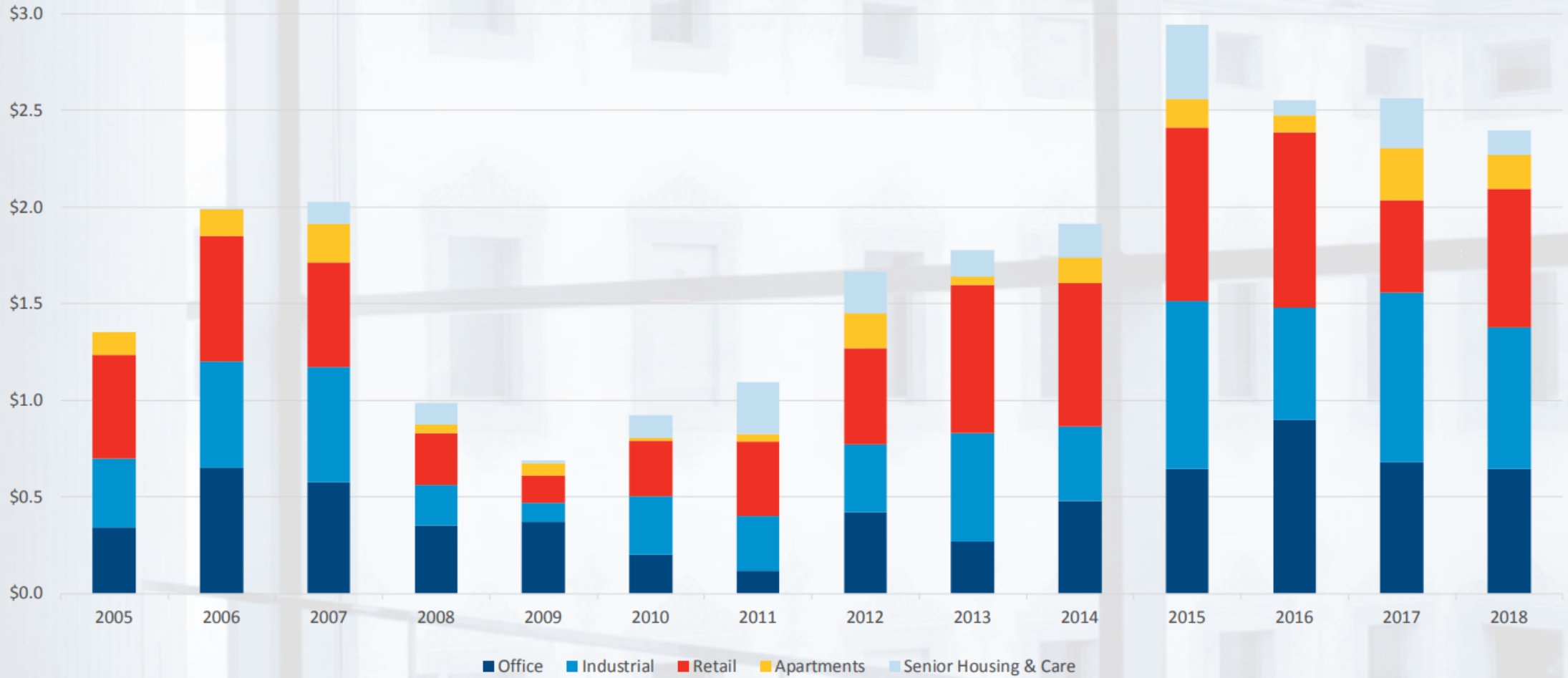
Employment Growth 2001-2018(Nov.)



Wisconsin Historical Transaction Volume

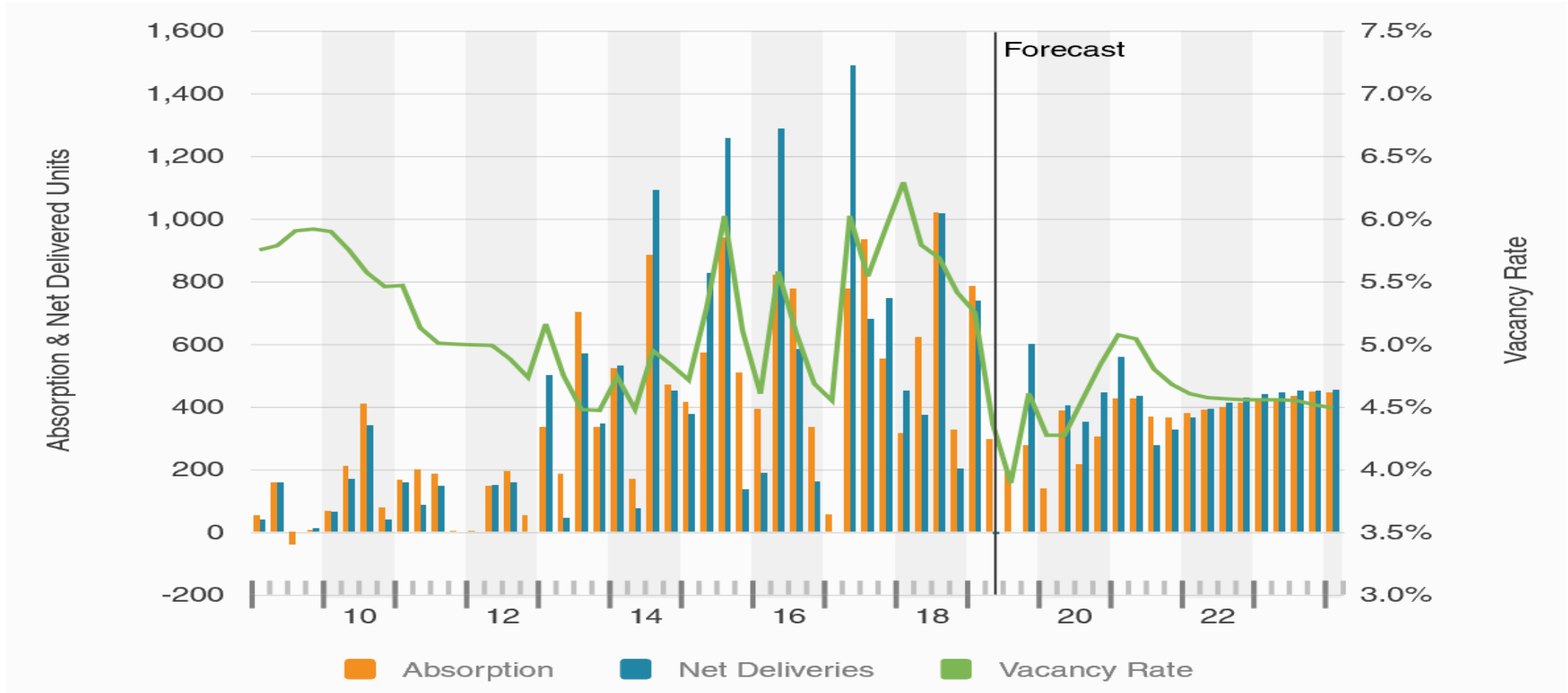
Transactions > \$2.5 million

in billions



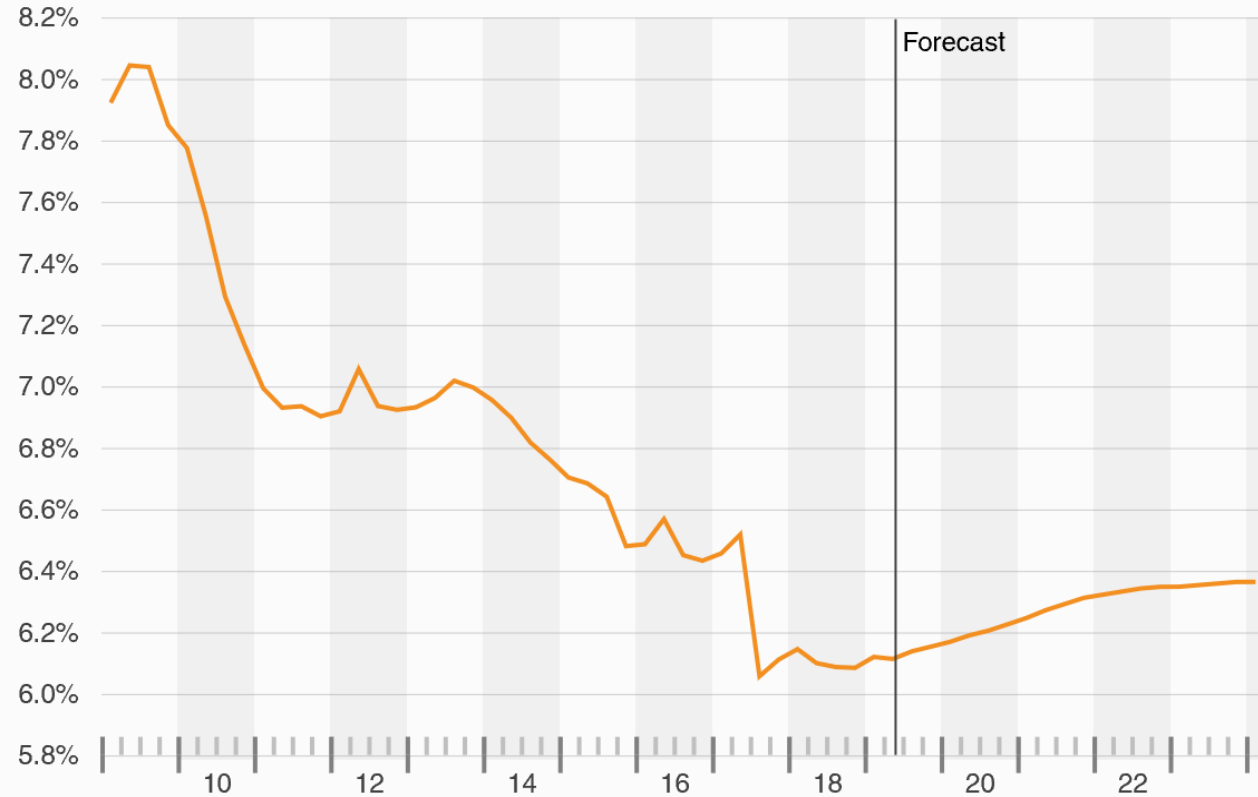
CoStar Dane County Apartment Inventory: 65,800 Units

Dane County Apartment Absorption, Net Deliveries, and Vacancy Rates

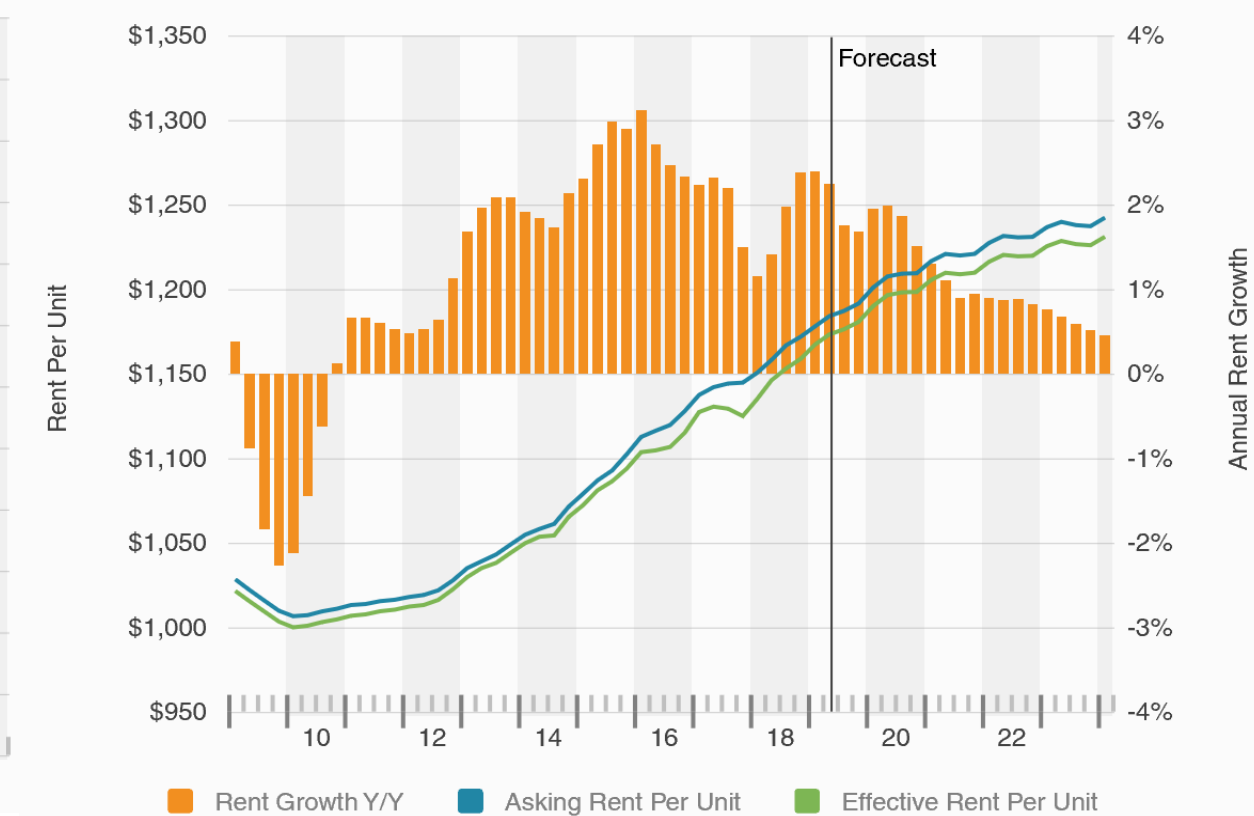


CoStar Dane County Apartment Inventory: 65,800 Units

Dane County Apartment Cap Rates

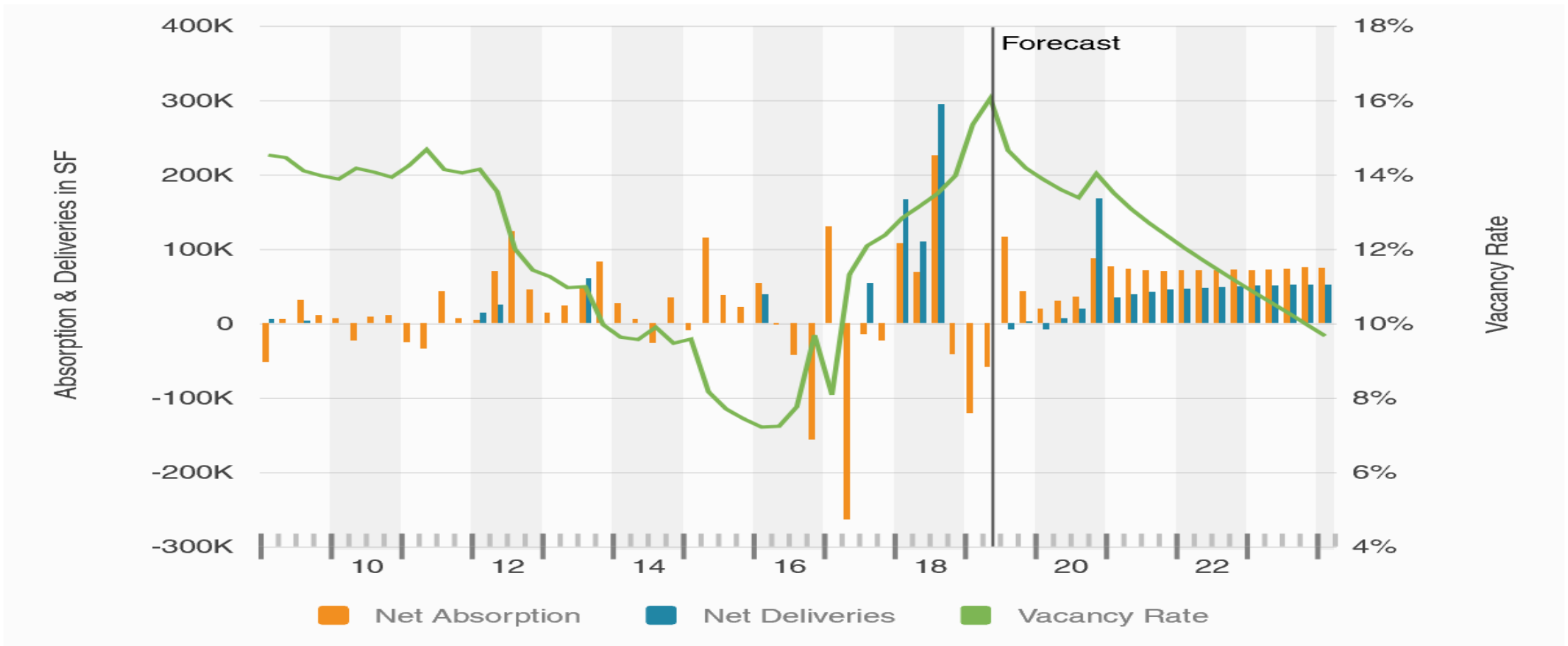


Dane County Per Unit Rent and Rent Growth Rates



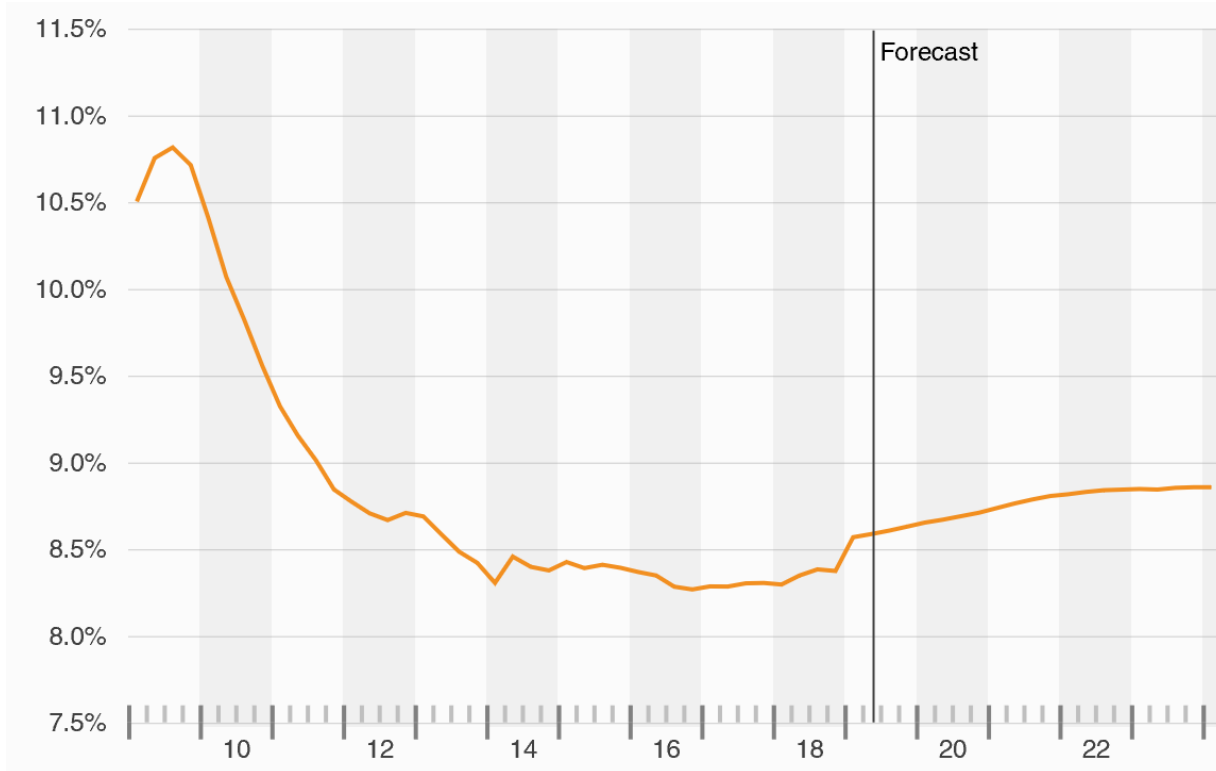
CoStar Dane County Office Inventory: 8.8 Million Square Feet

Dane County Office Absorption, Net Deliveries, and Vacancy Rates

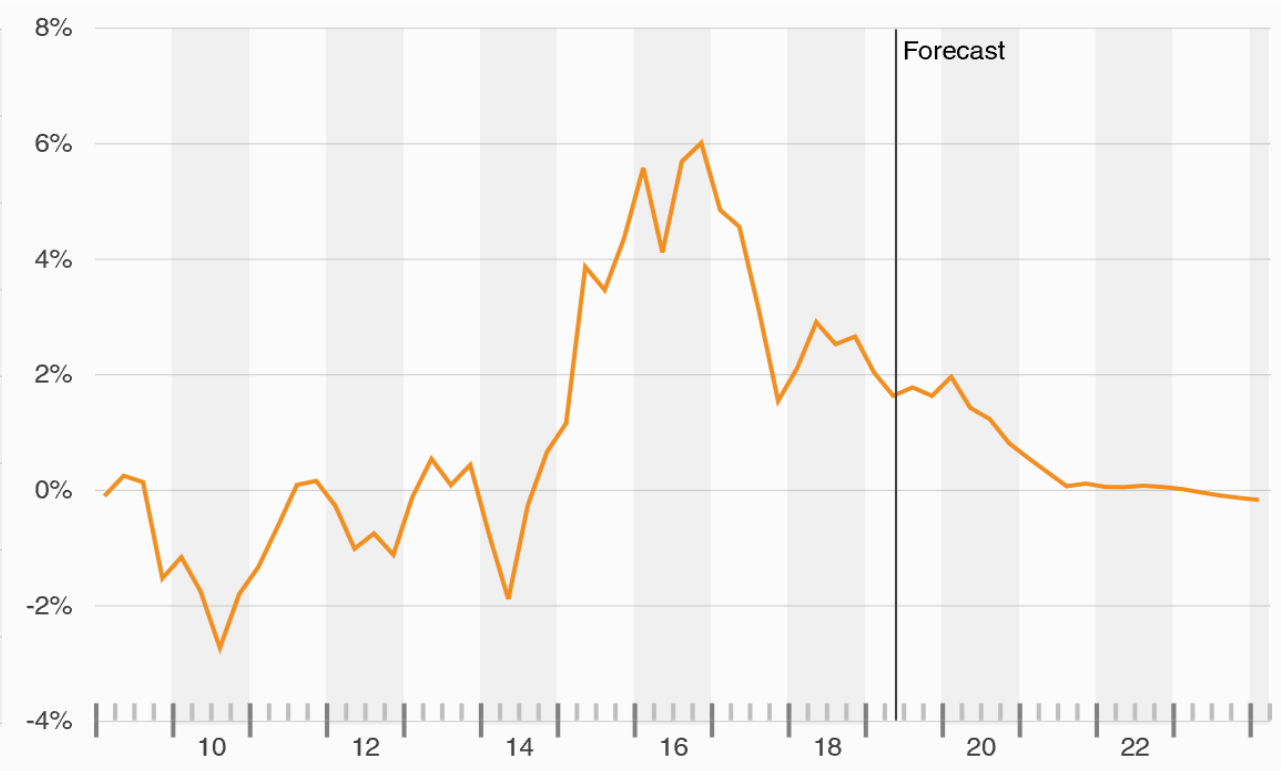


CoStar Dane County Office Inventory: 8.8 Million Square Feet

Dane County Office Cap Rates

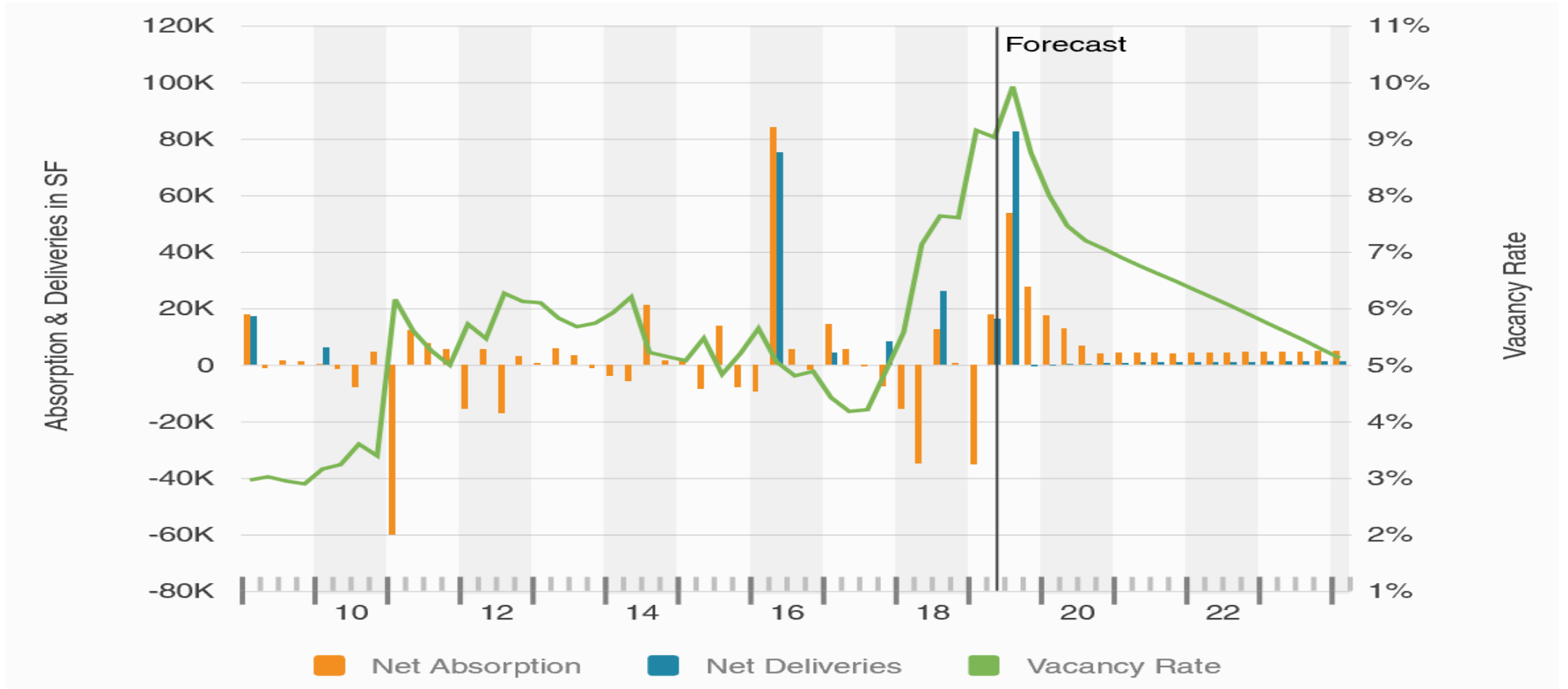


Dane County Office Rent Growth Rates



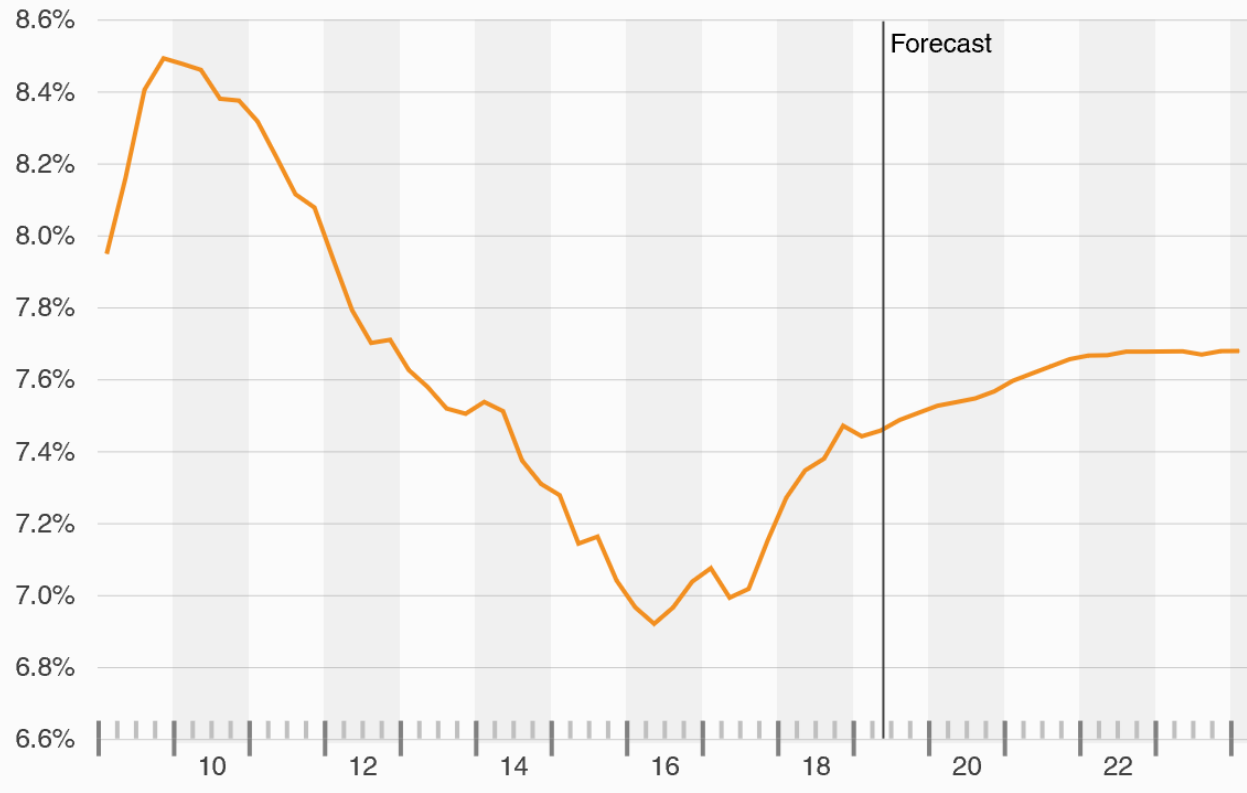
CoStar Dane County Retail Inventory: 2.4 Million Square Feet

Dane County Retail Absorption, Net Deliveries, and Vacancy Rates

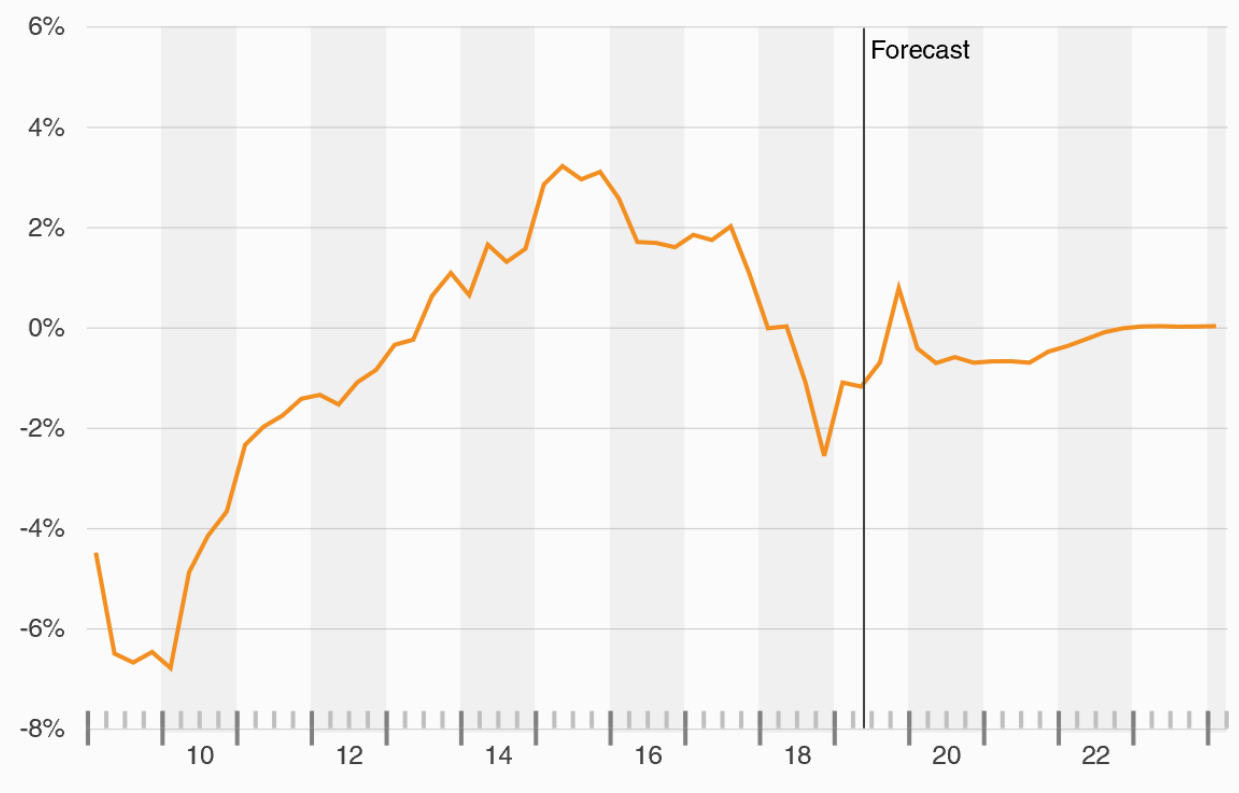


CoStar Dane County Retail Inventory: 2.4 Million Square Feet

Dane County Retail Cap Rates



Dane County Retail Rent Growth Rates



The Forecast

Asset prices:

- Cap rates will widen out by 25-50 bp to account for new risk premiums

Equity capital:

- Transaction volumes will fall by 5-10% over economic and pricing concerns

Debt capital markets:

- Will be robust, but tighten near year end

Space markets:

- Apartment overbuilding and weaker absorption will reduce YOY NOI

GDP growth:

- 2.0% YOY and falling

Wage inflation concerns will push interest rates higher, weak economy as an offset

- 10-year UST at 2.50-2.75%



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