1Q24

State of the U.S. Capital Markets

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Market Observations

- **Economy**. The U.S. economy continues to prove resilient to higher interest rates, though there are signs of deceleration as a range of hard and soft data indicators have underperformed expectations, including retail sales and consumer confidence. Unemployment remains low, but job openings and quit rates have been declining for some time now, signaling mutual contentment among employers and employees. Inflation remains the biggest headwind, which has reaccelerated in recent months proving that the last mile back to target remains an uneven one. Rate market expectations have been volatile, seeming to live from CPI print to CPI print. The market is now back to pricing two rate cuts in 2024, but the more important message is that the market has been consistently pointing to an equilibrium federal funds rate of 3.0% or greater, which would anchor long-term Treasury yields in the mid-3% range even after the Fed has normalized its policy stance.

- **Debt Markets.** CRE debt origination activity remained constrained in 1Q24, though it showed signs of a potential bottom. Overall, origination volume was down just 2% year-over-year in 1Q24. The number of active lenders continued to decline – now down 36% from peak. Industrial originations rose strongly in 1Q24 offsetting declines in other sectors. Refinancings via securitized lending drove the year-over-year increase in industrial originations. Overall, securitized, insurance and debt fund lending all rose as well, mostly offsetting a decline in originations from banks whose lending fell sharply. Regional banks face a protracted deleveraging from CRE. All this is occurring while the market is set to absorb $2.0 trillion in debt maturities in the 2024-to-2026 period. This debt will mature with significantly higher debt costs than when the loans were originated. Additionally, many loans are underwater or nearly so, especially recent loan vintages of most property sectors and broad swaths of office debt. We estimate that $679 billion in debt maturing between 2024 and 2026 is potentially troubled.

- **Equity Markets.** Investment sales declined 22% year-over-year in 1Q24 and negative 35% compared with the 2017-to-2019 average. Office sales actually rose 25% year-over-year in 1Q24 while all other property types fell. Liquidity has been strongest for smaller transactions. Deals under $100M made up 66% of volume traded in the last four quarters. Institutional investment remains anemic – down 55% year-over-year in 1Q24.

- **Supply of Capital.** Dry powder at closed-end funds currently sits at $257 billion, down 9% since December 2022. The capital remains concentrated in opportunistic and value-add vehicles, while debt strategies have pulled back. We estimate that 75% of this capital is targeting residential and industrial assets. Much of this dry powder was raised from prior vintages. Indeed, fundraising weakened from $140B in 2022 to $105B in 2023. Contributions to ODCE funds continued to recover from post-GFC lows in 1Q24, though many funds continue to face redemption queues. Restrictions on redemptions combined with continued uncertainty around asset marks have weighed on new fundraising and contributed to reductions in dry powder.

- **Pricing and Returns.** Transaction markets now show clear increases in transaction cap rates, following the public markets. Lower corporate bond yields have driven improvement in mortgage bond spreads. Nonetheless, both in the private and public markets, cap rates appear distinctly unattractive relative to the cost of debt capital, possibly excepting office REITs. This is not surprising in the private markets where transaction volumes are muted and reflect selection bias and appraisal-based valuations lag market conditions. Extremely narrow cap rate spreads in the REIT markets are harder to justify and seem to require a rapid decline in debt costs, historically abnormal NOI growth or a combination of the two. Notwithstanding the structural deficiencies in NCREIF valuations during periods of rapid change like today, NCREIF NPI broadly improved in 1Q24 to negative 3.9% annualized overall. Hotel, retail and industrial recorded positive total returns. 56% of markets recorded positive total returns in 1Q24 up from just 19% in 4Q23.

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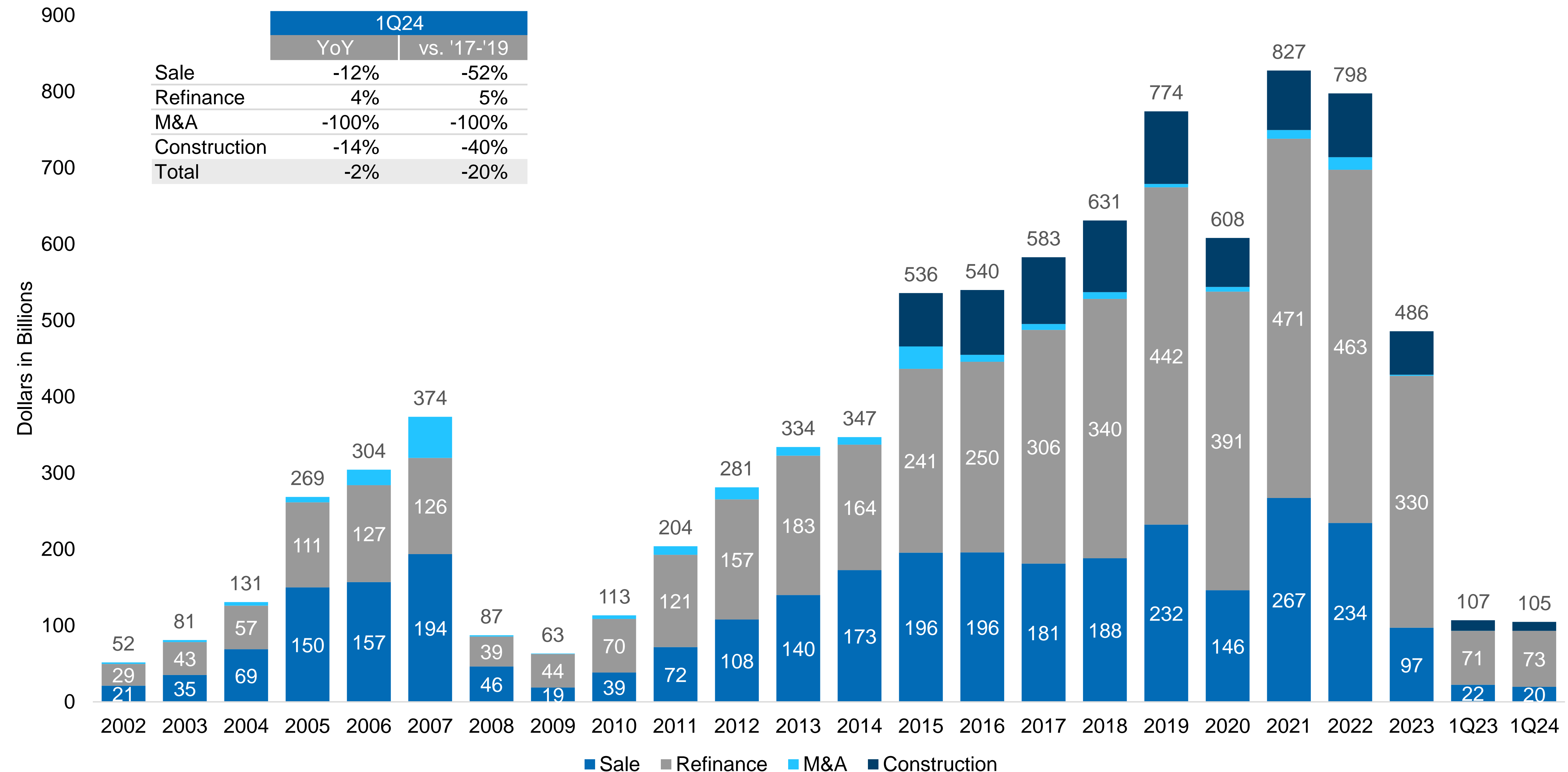
1Q24 US CAPITAL MARKETS REPORT

Debt Capital Markets

Debt Origination Flat Year-over-Year in First Quarter of 2024

Activity in the first quarter of 2024 gave the first suggestion that debt originations may have bottomed. Originations were essentially flat in 1Q24 and compared to 1Q23. Sale financing was down more sharply, but this was largely compensated for by a small increase in refinancing volumes. There was a brief window in the first quarter of 2024 when markets believed that rates would come down significantly in 2024, leading to declines in Treasury yields. Some borrowers took advantage of this window.

Commercial Real Estate Debt Origination Volume

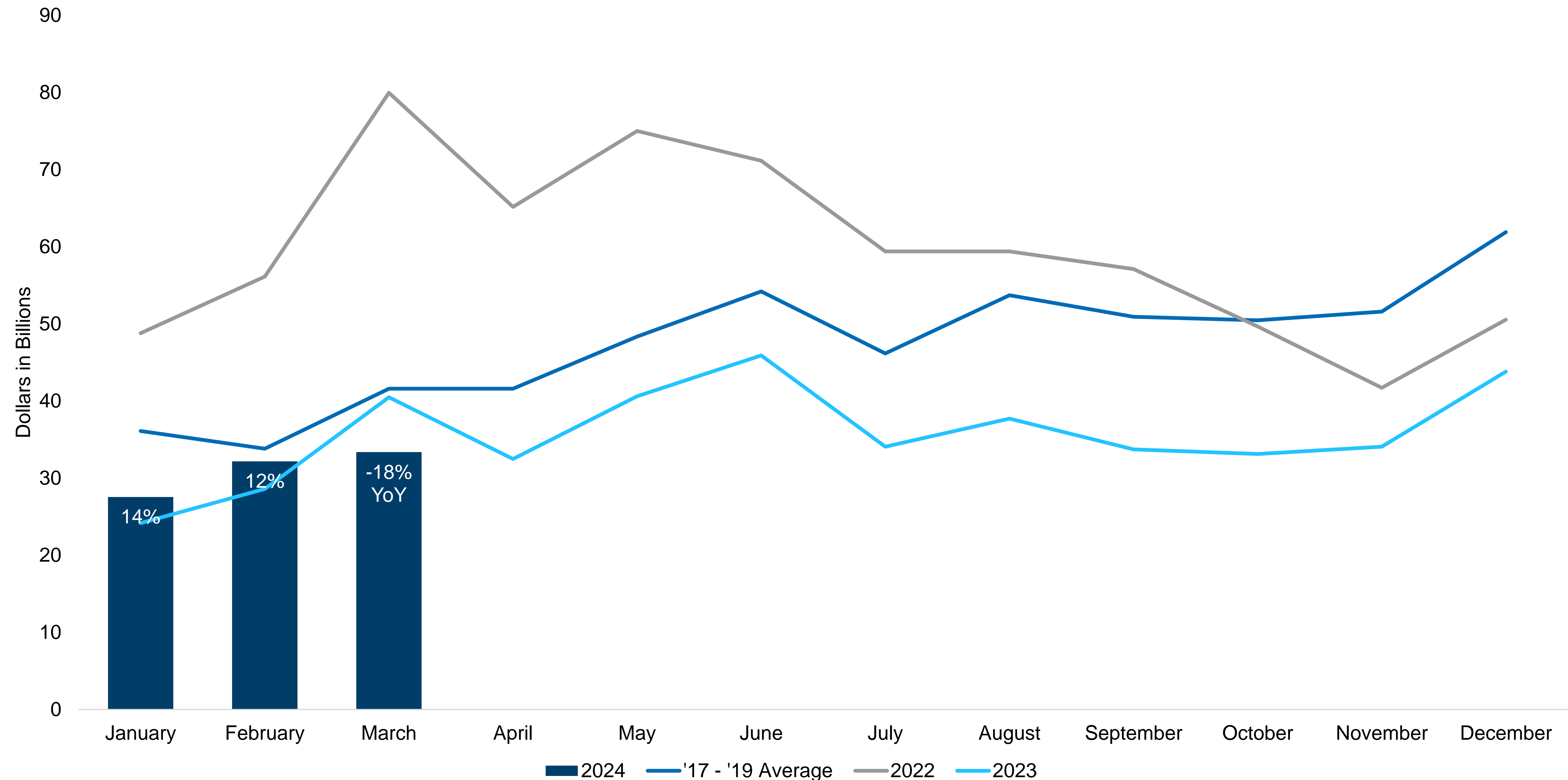


Source: RCA, Newmark Research as of 4/26/2024
Note: Loan origination volumes are adjusted for future expected revisions using Newmark's proprietary models.

Monthly Originations Broadly In-Line with 2023 Levels

With the benefit of more data and Newmark's new revision forecasting model, it is now possible to see that the market did experience a seasonal boost in financings in December – further supported by sharp declines in Treasury yields at that time. Originations in January and February ran above their year ago pace with February nearly matching the pre-pandemic average. These deals were supported by strong sentiment early in 1Q24. By March, however, rising long-term rates appear to have cut short accelerating activity.

Monthly Commercial Real Estate Debt Origination Volume



Source: RCA, Newmark Research as of 4/26/2024
Note: Loan origination volumes are adjusted for future expected revisions using Newmark's proprietary models.
**Excludes construction loans

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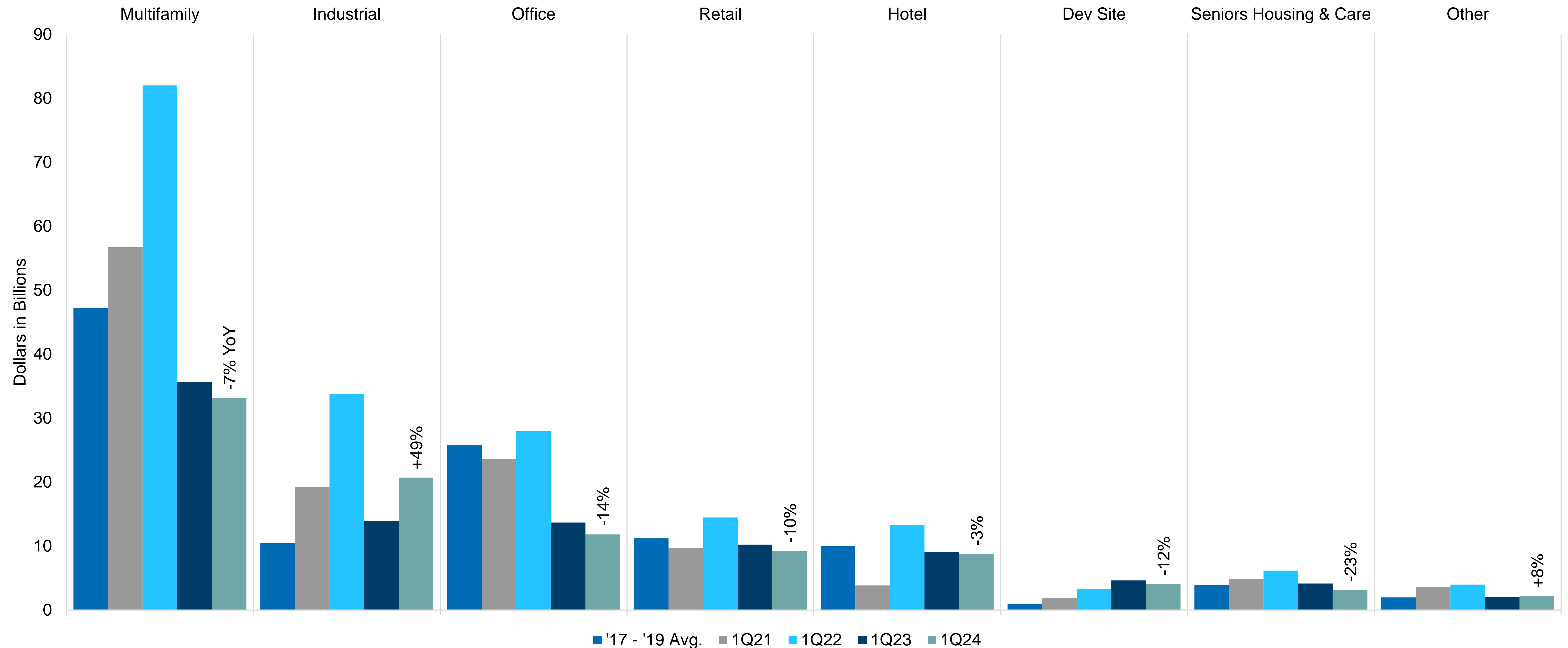
Originations Declined Year-over-Year in 1Q24, Except for Industrial

Office (-54%) and multifamily (-30%) lending declined the most in 1Q24 compared with their respective 2017 to 2019 averages. In contrast, industrial originations were up 49% year-over-year and up 97% compared with the 2017-to-2019 average.

Commercial Real Estate Debt Origination Volume

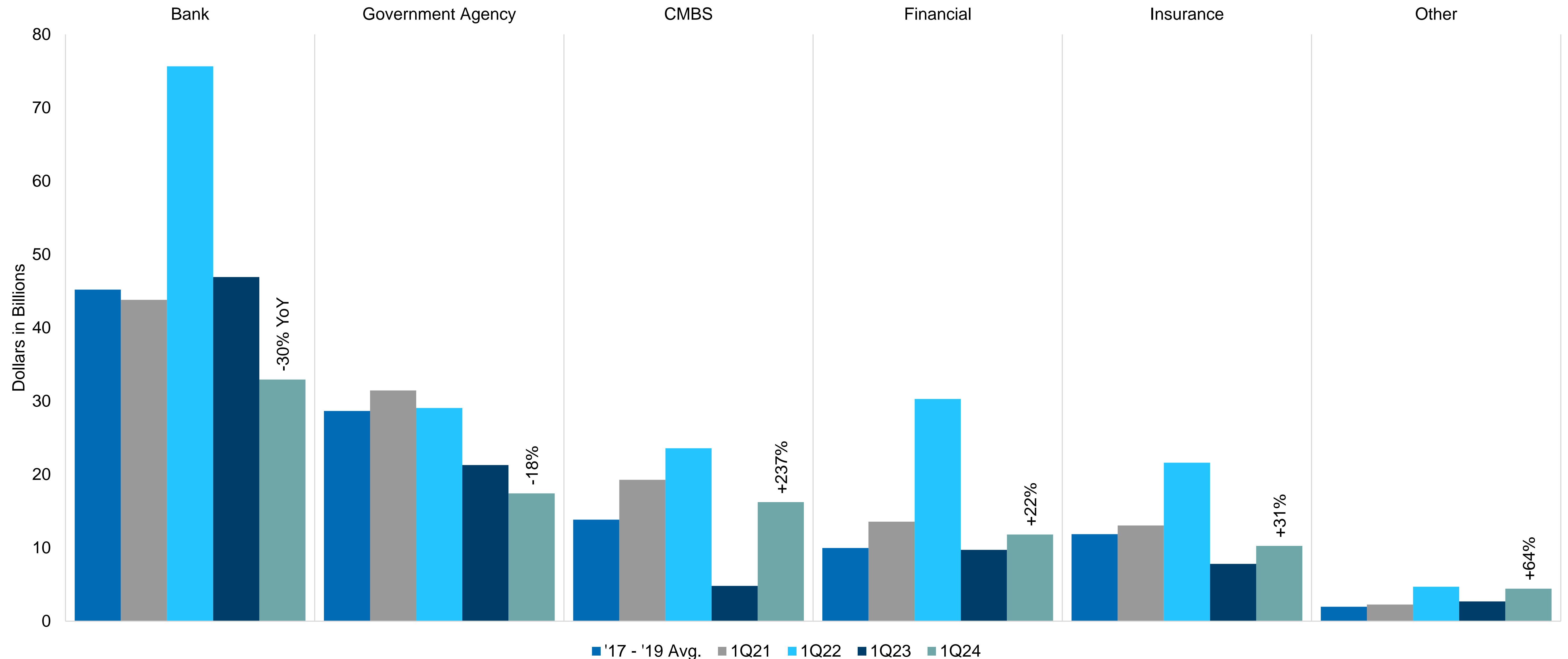


Source: RCA, Newmark Research as of 4/26/2024
Note: Loan origination volumes are adjusted for future expected revisions using Newmark's proprietary models.
**Excludes construction loans

Debt Funds, LifeCos and Securitized Lenders Increased Activity in 1Q24

Banks originations remained weak in 1Q24, down 30% compared with 1Q23 and down similarly compared with the 2017-to-2019 period. This was largely offset by increases in lending for securitization, debt funds and insurance companies. Government agency lending appears down even with revision forecasting adjustments; however, this could reverse as Fannie/Freddie report that new business volumes have increased year-over-year.

Commercial Real Estate Debt Origination Volume

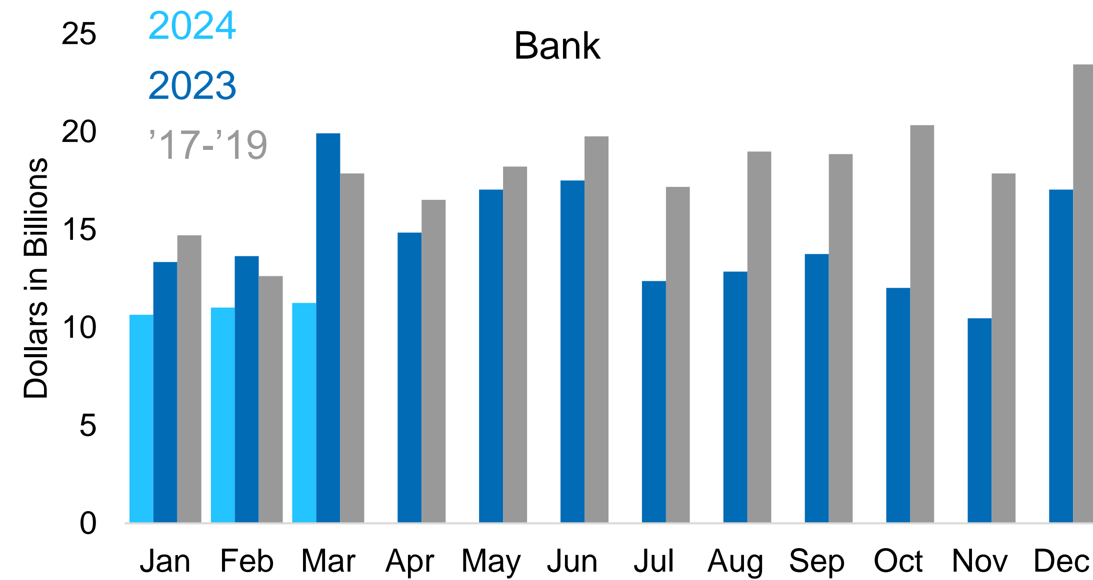


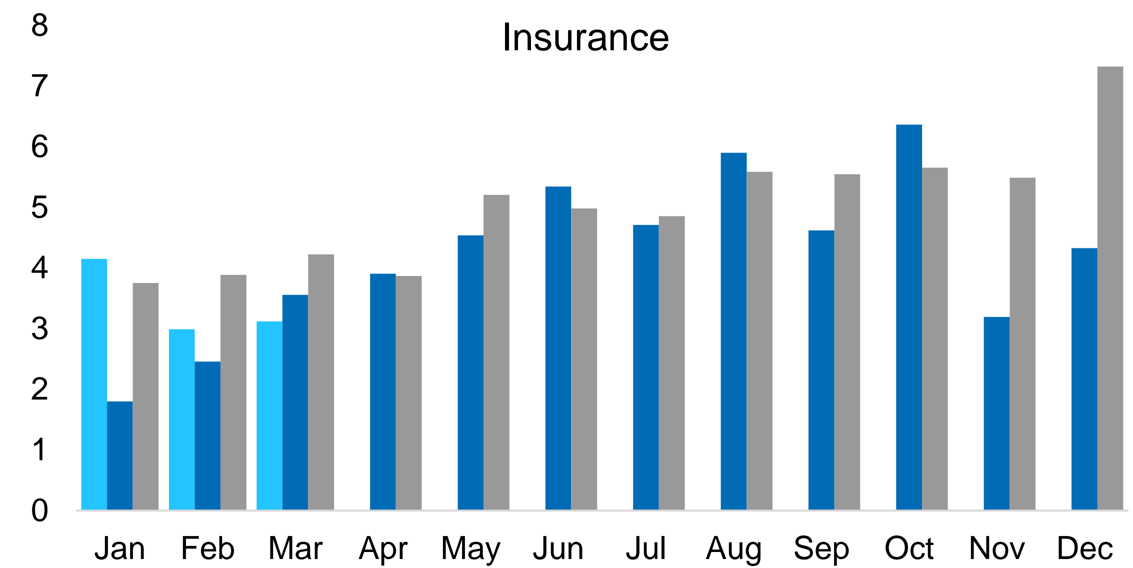
Source: RCA, Newmark Research as of 4/26/2024
Note: Loan origination volumes are adjusted for future expected revisions using Newmark's proprietary models.
**Excludes construction loans

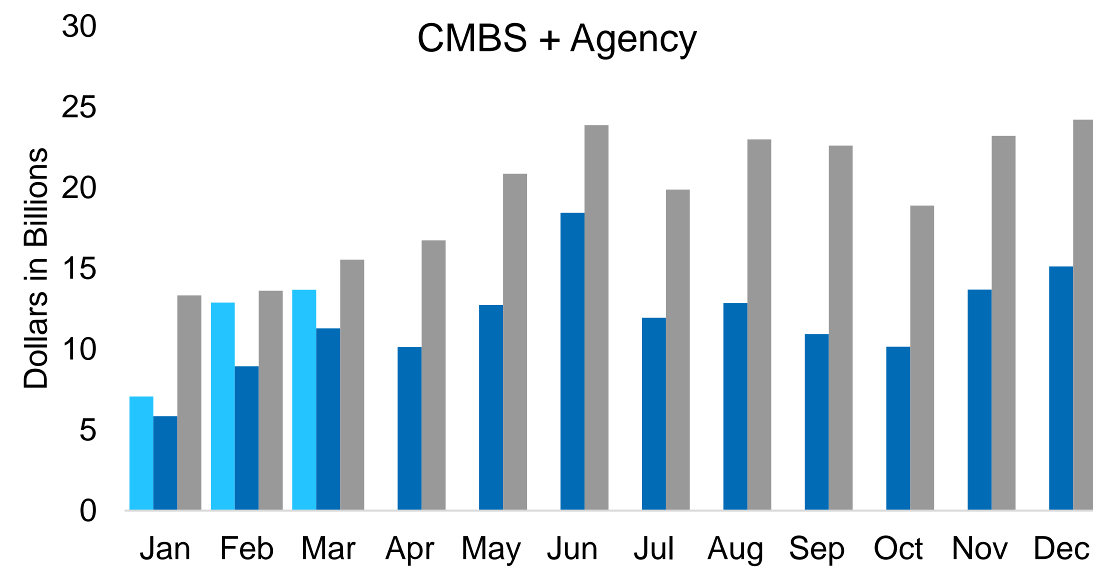
Non-Bank Loan Originations Picking Up

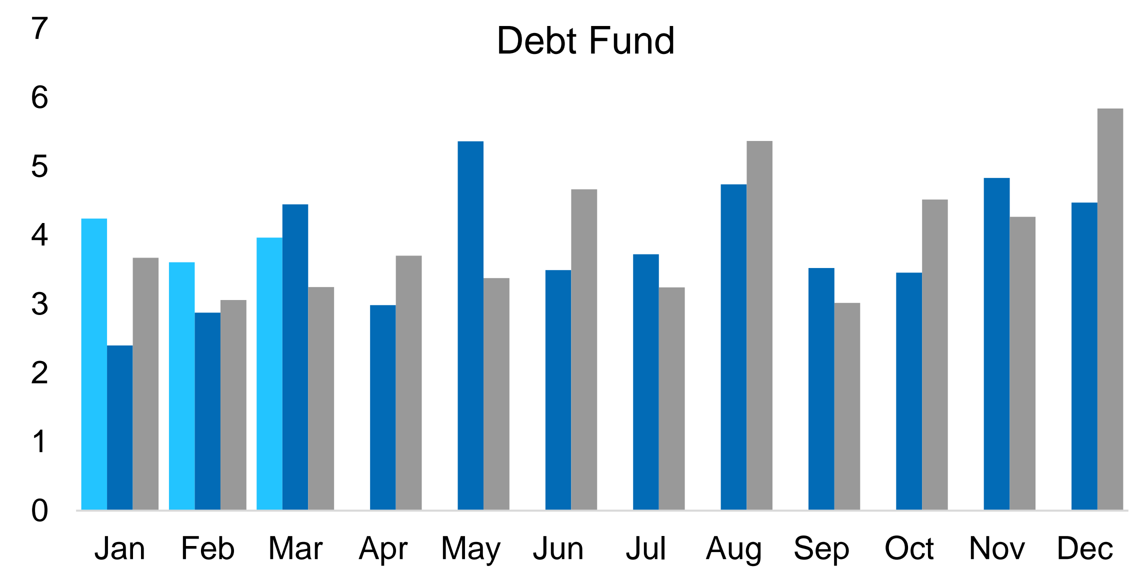
Securitized, insurance and debt fund lending were running above 2023 levels in the first quarter of 2024. Debt fund originations in particular are outperforming pre-pandemic. Insurance lending was particularly strong in January but has moderated on the margin since. In contrast, securitized lending has shown positive momentum. Bank originations have been consistently weak with the difference showing, particularly in March.

Commercial Real Estate Debt Origination Volume







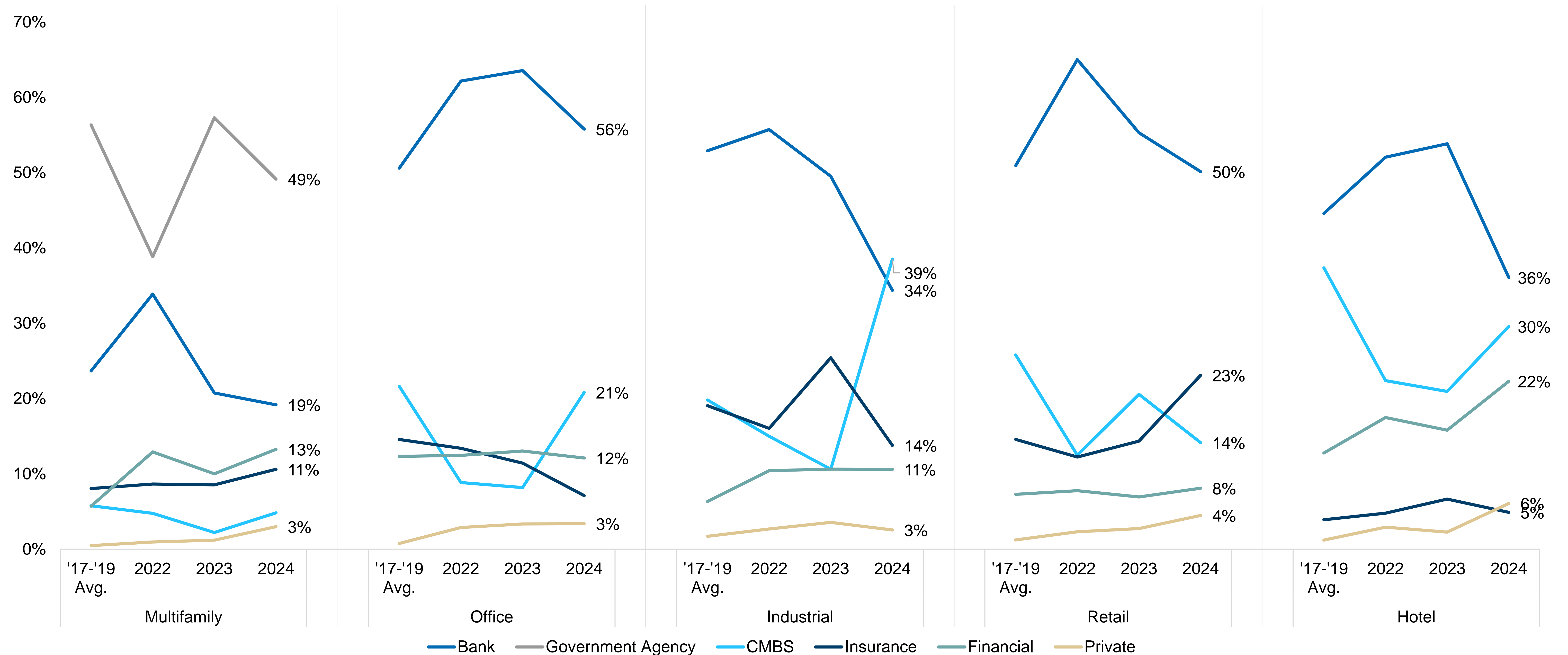


Source: RCA, Newmark Research as of 4/26/2024
Note: Loan origination volumes are adjusted for future expected revisions using Newmark's proprietary models.
**Excludes construction loans

Bank Share of Originations Beginning to Fall

Banks remain the dominant source of CRE finance, but the bank share fell sharply in the first quarter of 2024 across property types. On the other hand, securitized and debt fund financing are broadly rising.

Composition of Commercial Mortgage Debt Originations



Source: RCA, Newmark Research as of 4/26/2024
Note: Loan origination volumes are adjusted for future expected revisions using Newmark's proprietary models.
**Excludes construction loans

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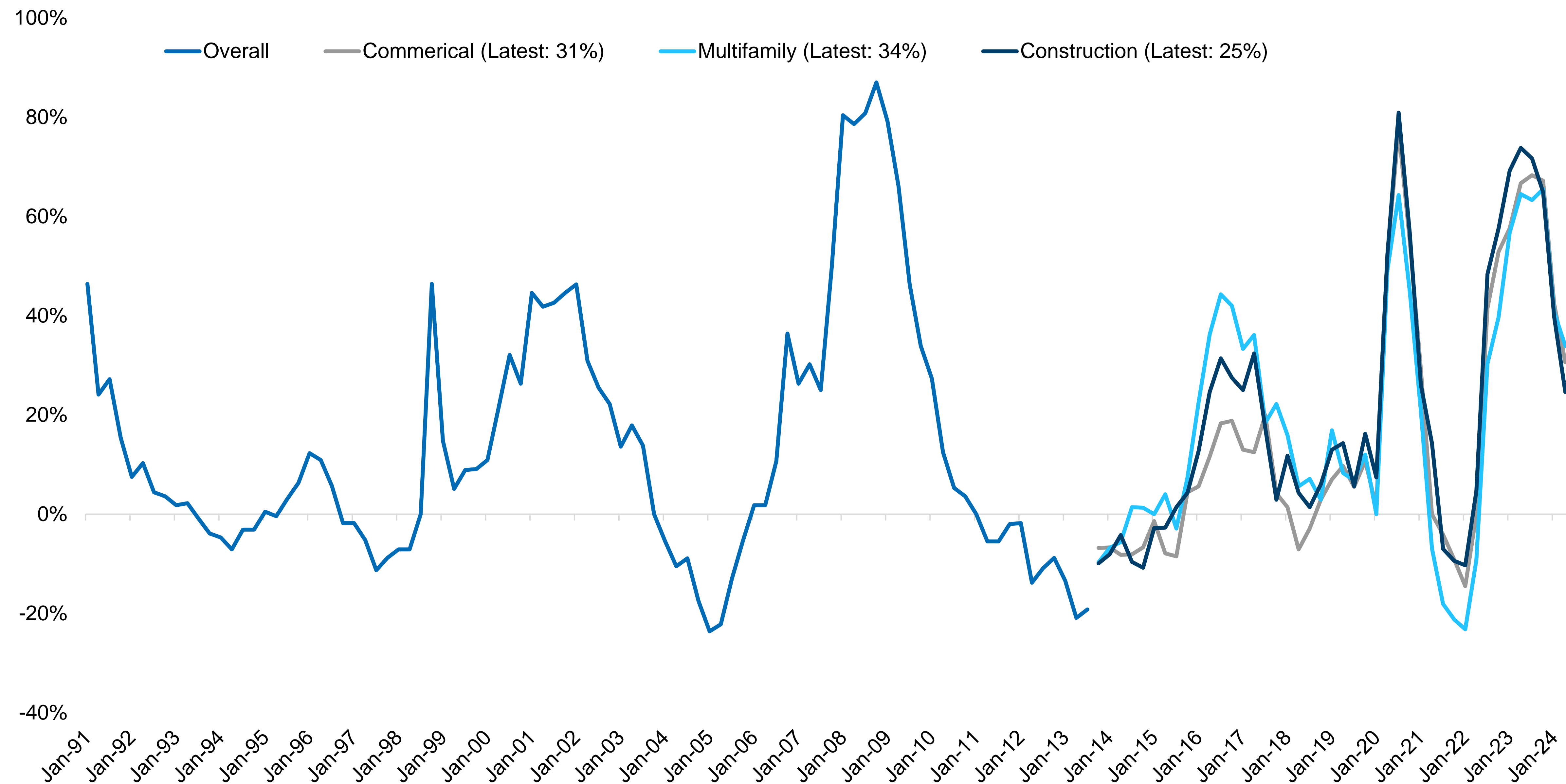
Banks Are Still Tightening Standards, But Pace of Tightening Has Slowed

Most banks expect to continue tightening lending standards in 2Q24; however, the net share tightening came sharply down from a peak of ~65%. This is a salutary development, but it's still the first step on what is still likely to be a long road to a healthy CRE finance environment. Banks took at best muted steps to resolve issues in their CRE books in 2023, pushing them to 2024. Financial conditions have improved but not enough to resolve most problem loans. As a result, banks will have limited capacity to extend new credit.

Net Percentage of Banks Tightening Lending Standards

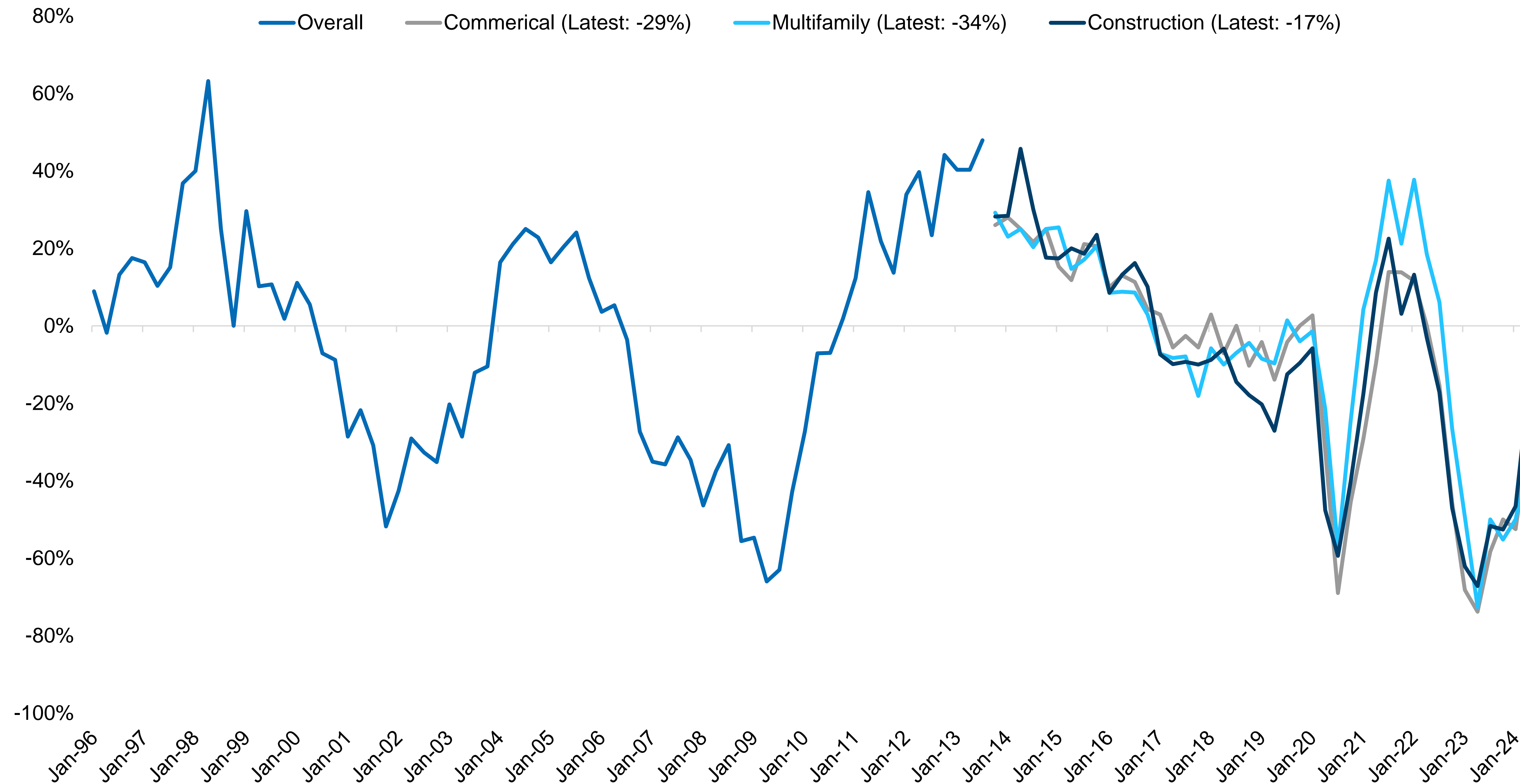


Source: Federal Reserve, Newmark Research as of 5/7/2024

Demand for *New* Bank CRE Credit Getting Closer to Stabilization

Both borrowers and lenders are heavily preoccupied with legacy loan maturities and the sustainability thereof. That said, conditions have improved on the margin since the regional banking mini-crisis in early 2023.

Net Percent of Banks Reporting Stronger CRE Loan Demand



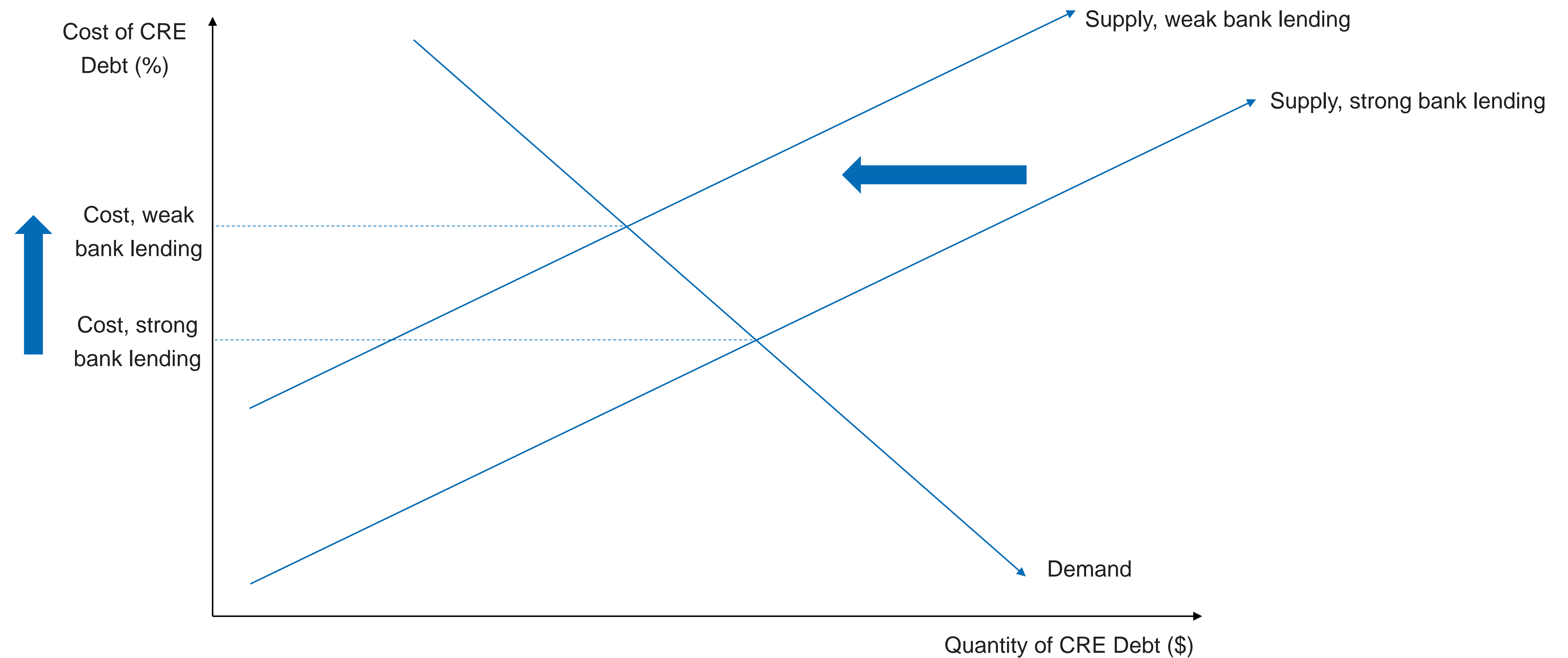
Source: Federal Reserve, Newmark as of 2/6/2024

Banks are likely to spend the next several years reducing their CRE exposures. This would be a negative supply shock to the CRE finance ecosystem.

If Banks Continue to Pull Back, Debt Costs Increase

Econ 101 shows us why this is the case. Higher yields are needed to induce banks to sustain lending and attract other sources of capital to lend to the sector. This is not always a smooth process, resulting in lags during which interest rates could easily overshoot their eventual equilibrium. It's important to keep in mind that this supply shock is *in addition to* the supply shock resulting from the increases in Treasury yields. As such, not only does bank retrenchment signal higher rates, but also higher *relative* rates.

Supply and Demand of CRE Credit

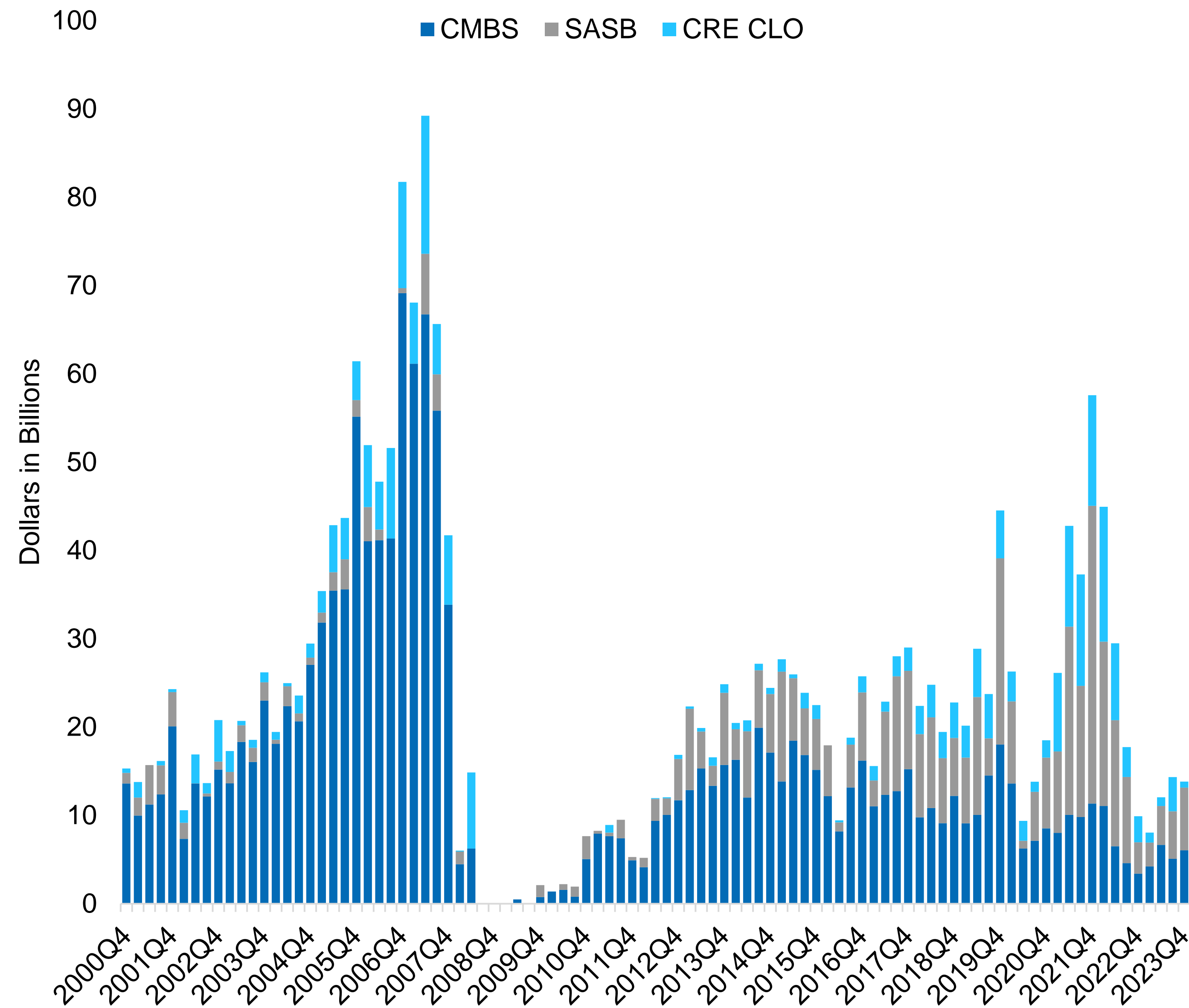


Source: Newmark Research

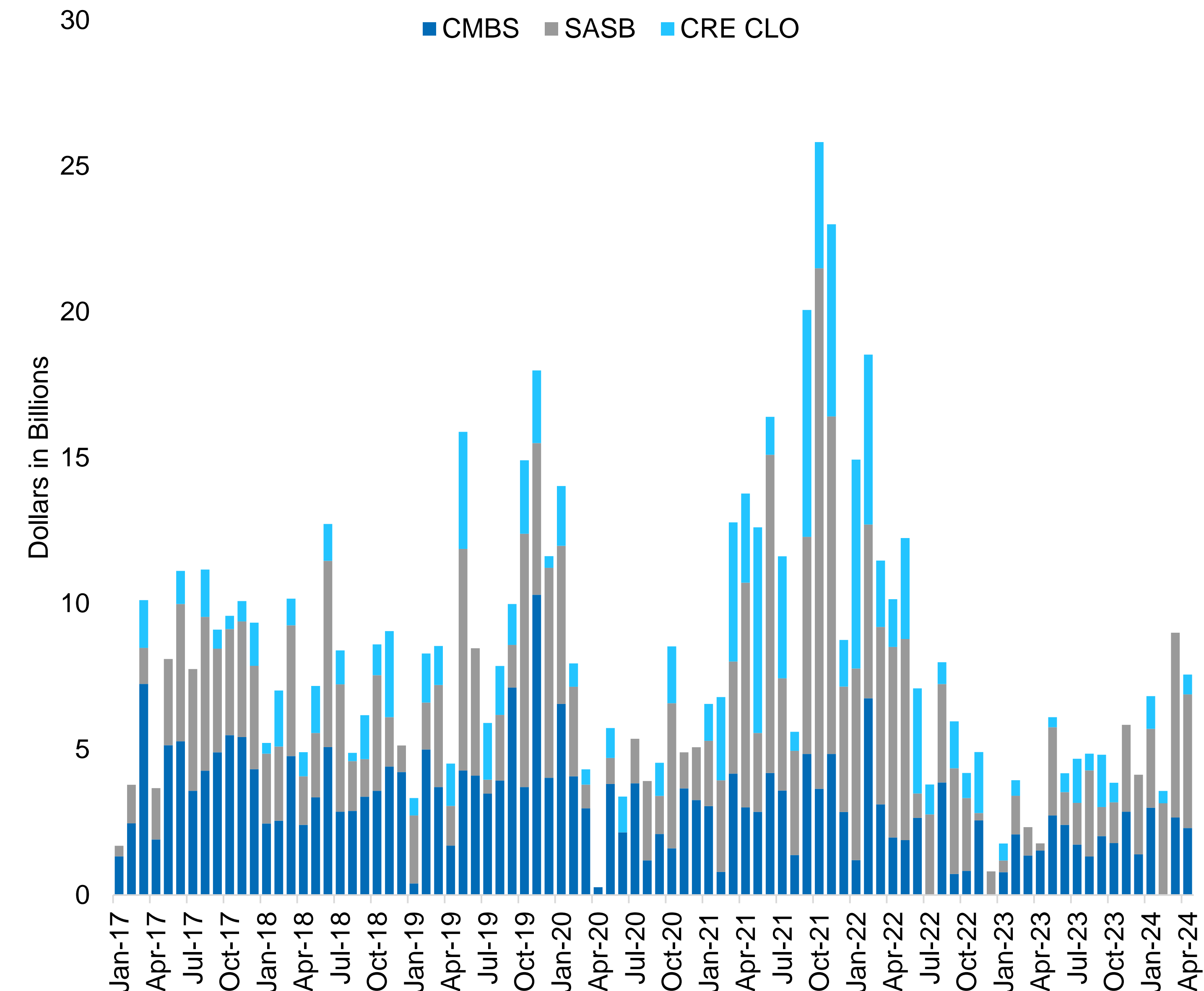
Securitized Markets Re-Accelerating, Particularly SASB

Demand for CRE securitizations has increased in recent months as a result of higher spreads on offer as compared with corporate debt. This yield advantage has attenuated somewhat, so it is an open question as to whether the bid will remain as strong. SASB structures have accounted for 63% of originations in the first quarter and drove much of the increase. While greater execution certainty in securitization markets is a positive development, it remains too small to significantly mitigate bank CRE deleveraging.

Quarterly CMBS Issuance



Monthly CMBS Issuance

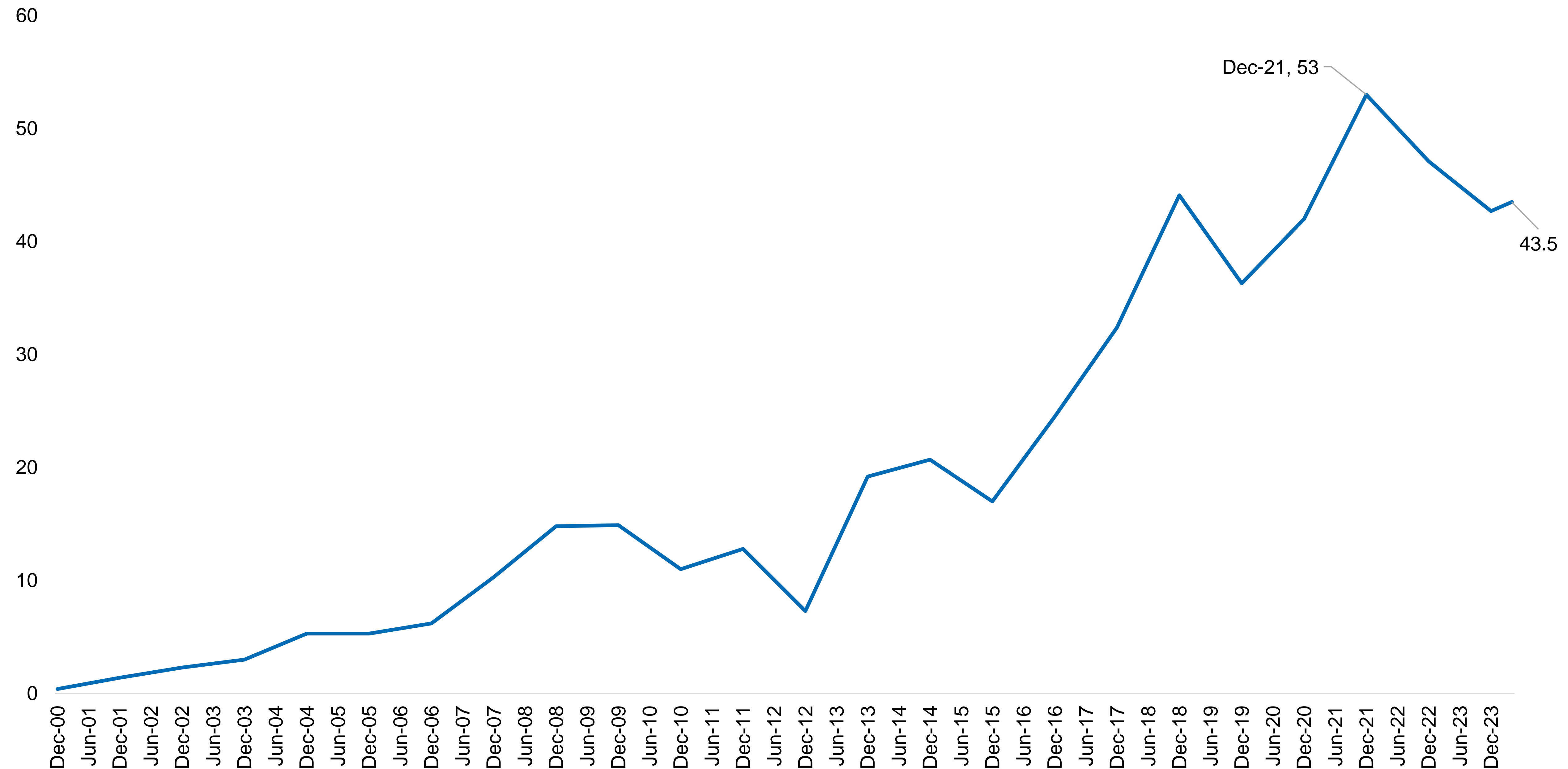


Source: Green Street, Newmark Research as of 5/7/2024

Debt Fund Dry Powder Elevated, But May Be Cannibalized to Bail-in Existing Loans

CRE CLO issuance remains anemic, which means that loan rehypothecation channels remain largely closed for debt funds. Meanwhile, rising troubled debt issues with CRE CLO books are pressuring debt funds to buyout these underperforming loans – in effect bailing out the CLO holders. According to JP Morgan, CLO loan buyouts have exceeded $500M for the last two quarters. On the other hand, the departure of bank lenders is opening opportunities for debt funds to fill in the gaps with potentially attractive risk-adjusted returns.

Debt Fund Dry Powder



Source: Newmark Research, Preqin as of 4/30/2024

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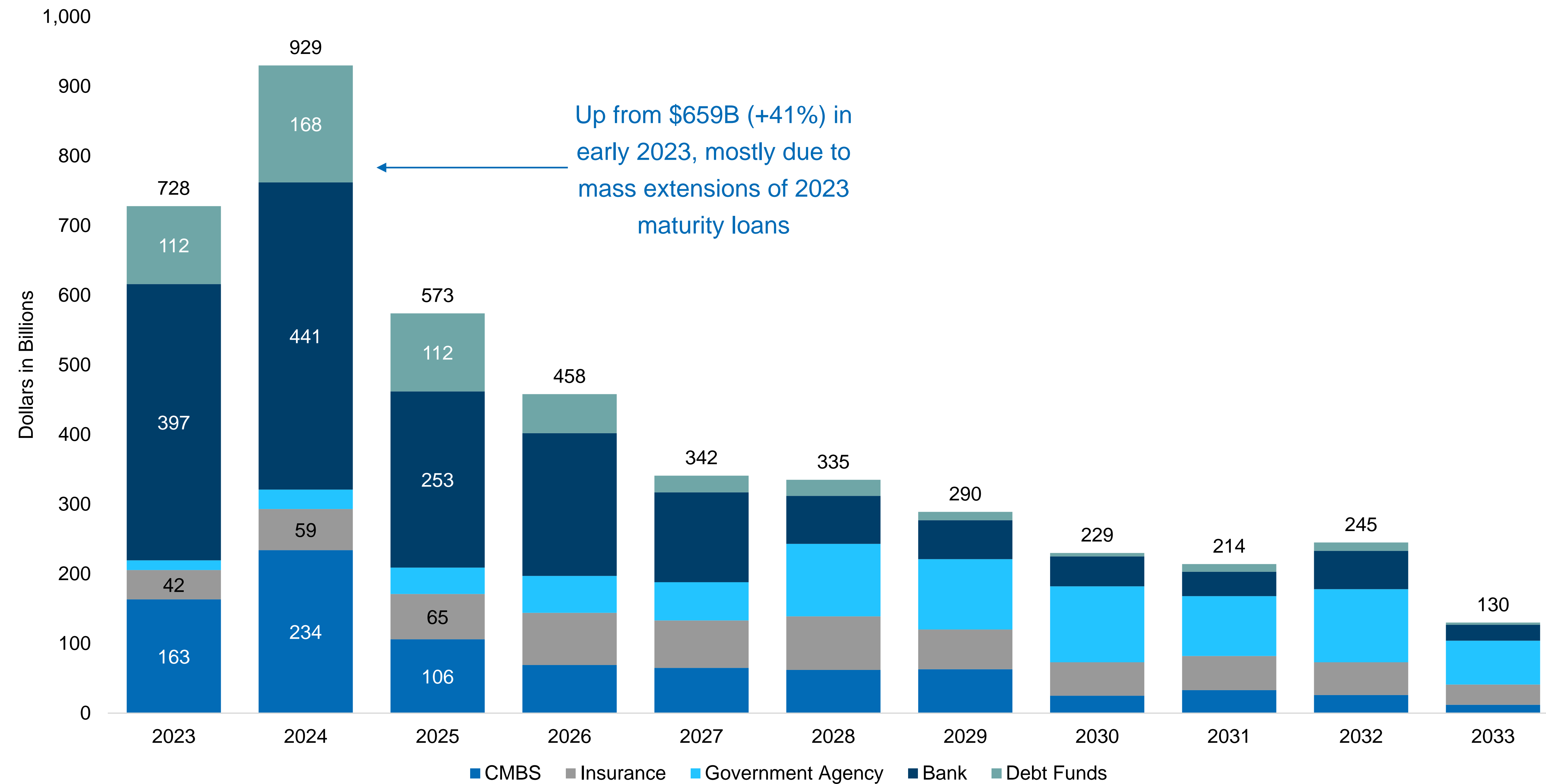
Market Face Record Maturities in 2024

Bank, CMBS/CRE CLO and debt fund maturities are particularly heavily front-loaded over the next 12 months.

Commercial Mortgage Maturities



Source: MBA, Newmark Research as of 2/12/2024

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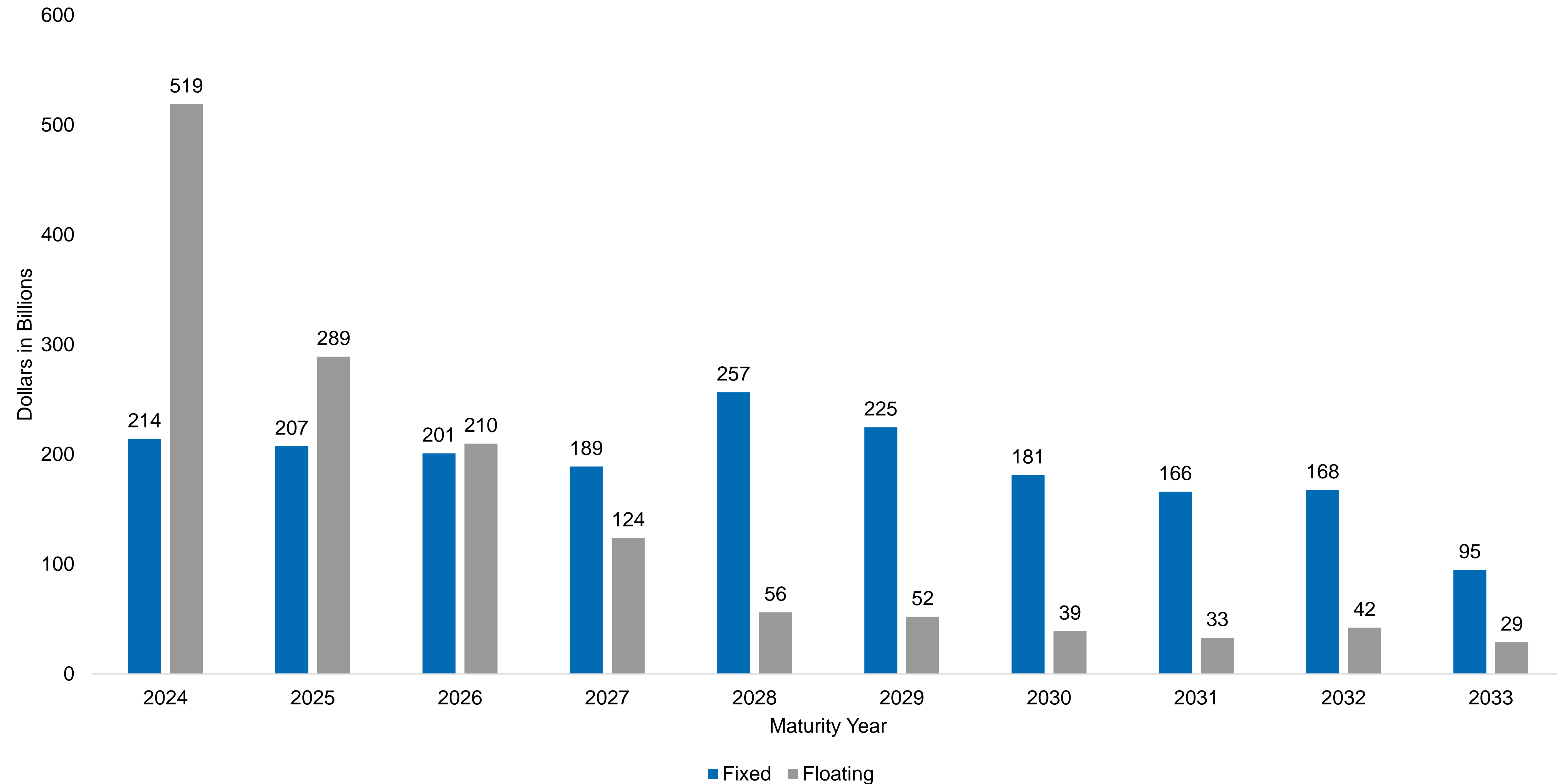
Estimated $519B in Floating Rate Loans Mature in 2024, $1.1T in ’24-’26

Floating rate loans are the most likely to be facing cash flow problems. Extensions of existing loans at in-place rates offer little comfort to these borrowers in contrast to the fixed rate market. As such, floating rate loans are most likely to exhibit distress.

Commercial Mortgage Maturities: Fixed Rate vs. Floating Rate*



Source: RCA, MBA, Newmark Research as of 5/23/2024
*Includes office, multifamily, industrial, retail, hotel and healthcare property sectors. These figures are estimates and may differ both from MBA’s published figures and from Newmark’s model projections for property and lender sector totals. Analysis does not incorporate the effects of rate caps.

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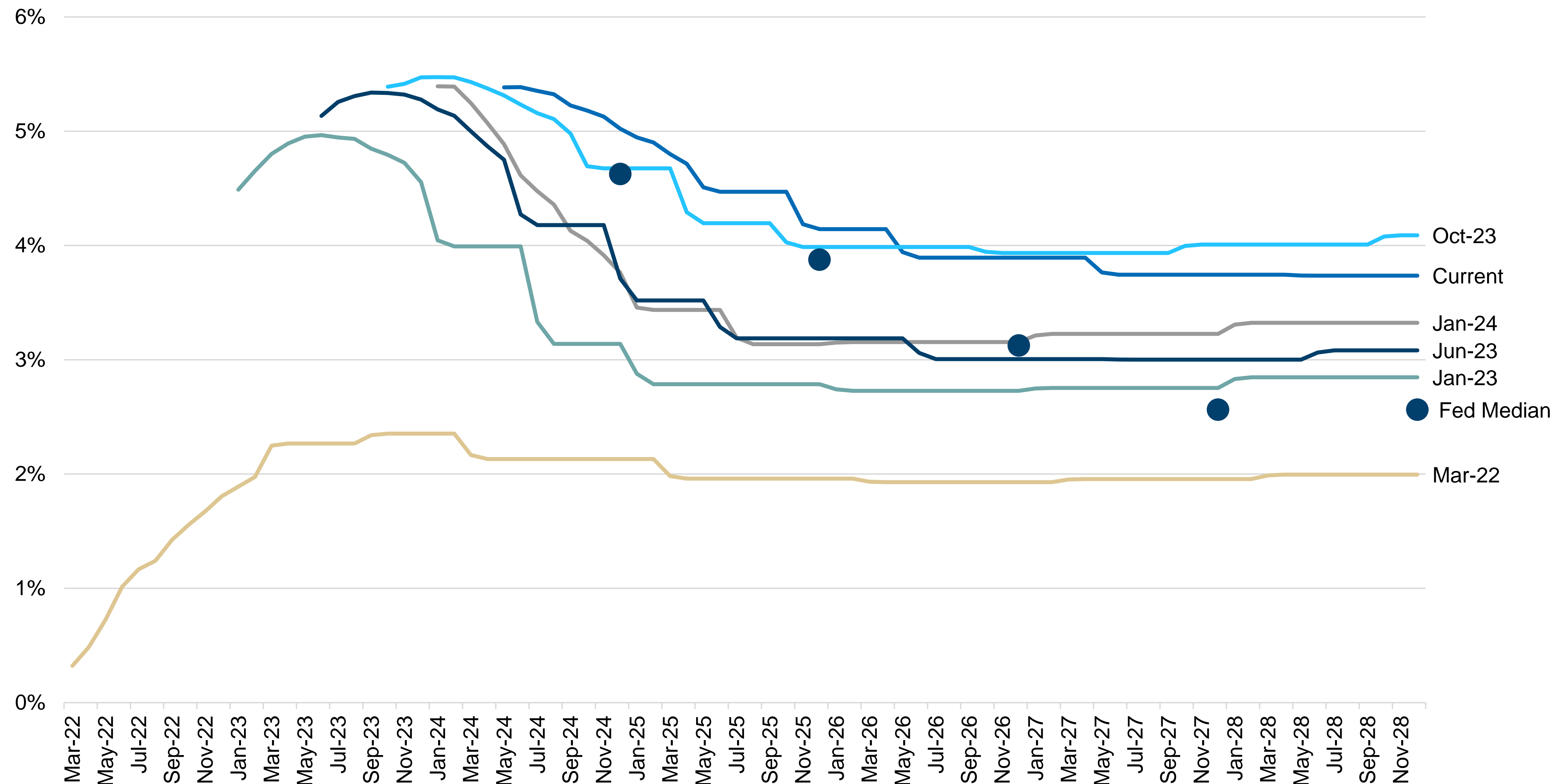
Both Markets and Fed Expect Persistently Higher Cost of Capital vs. Post-GFC

Forward rate projections have varied widely over the last 24 months, but at no time have they anticipated a rapid return to post-GFC short rates. Without this prospect, long-term rates too are likely to remain locked in higher ranges. In addition, quantitative tightening and large government deficits will continue to place upward pressure on the term premium.

U.S. Rates Forward Curve: 1-Month SOFR



Source: Chatham Financial, Newmark Research as of 5/22/2024

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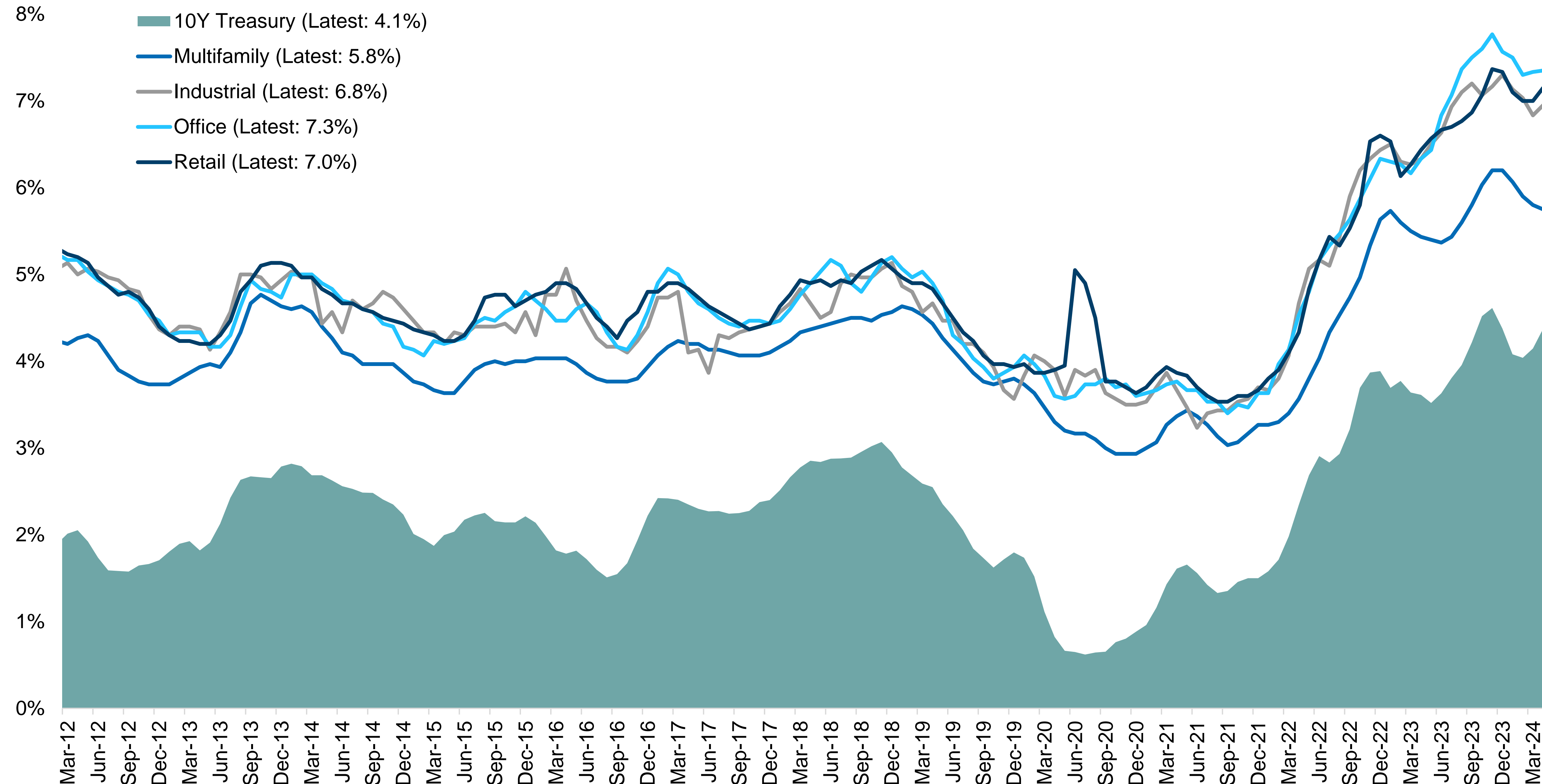
Fixed-Rate Debt Costs Fell with Treasury Yields and Bond Spreads in Late 2023

However, as rates began to rise once more in April and into May, it seems likely that there were similar movements in CRE debt costs as further reductions in spreads seem unlikely given the state of risk appetite. Non-multifamily spreads to treasuries are currently above long-term averages (2.8% vs. 2.3% average) whereas multifamily spreads are more aggressively priced (1.4% vs. 1.8% average).

Average Interest Rate on Fixed Rate CRE Originations

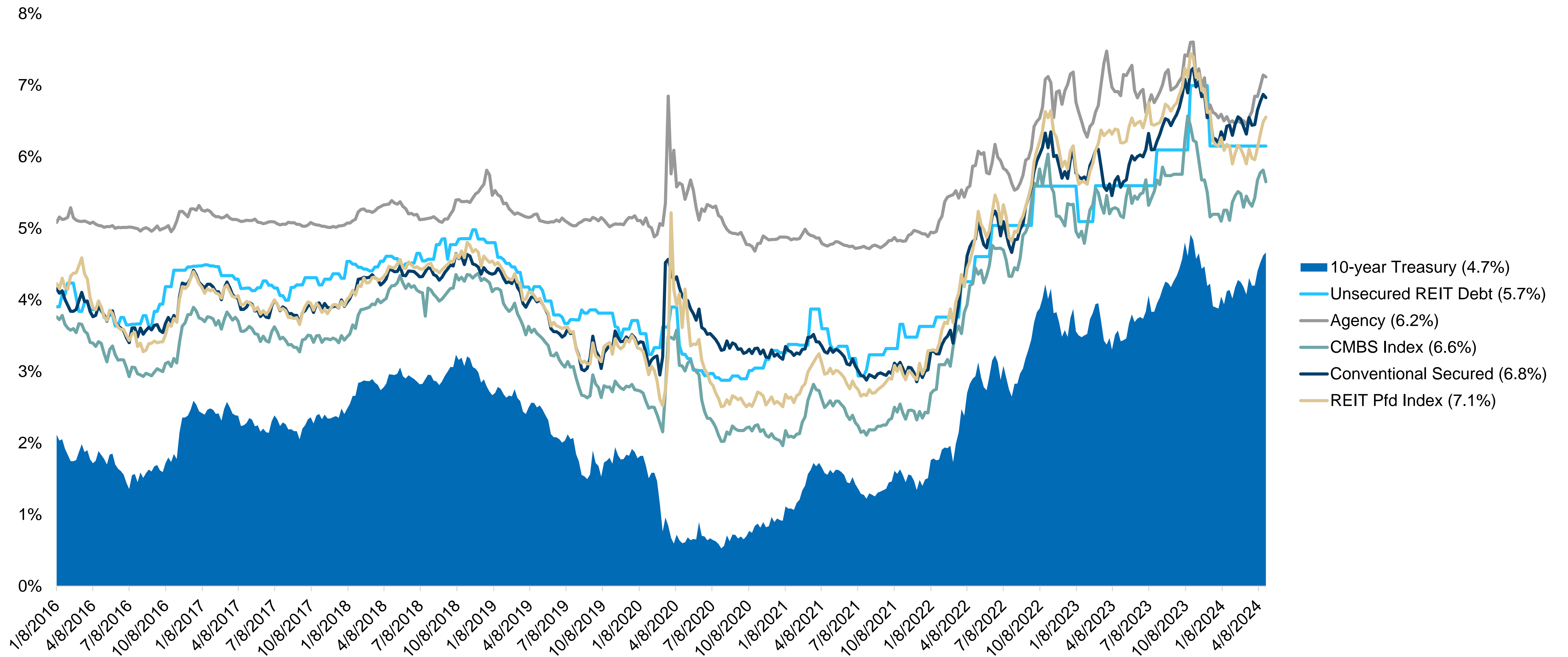


Source: Real Capital Analytics, Newmark Research as of 5/7/2024

But Public Market CRE Benchmarks Point to Recent Increases Alongside Treasuries

Public market benchmarks were faster to rise than private transaction-based measures. Both through direct lending and by purchasing publicly-traded instruments, fixed-income investors are now able to pick up additional yield by investing in CRE relative to corporate credit. This should attract some capital inflows from lenders with optionality, namely LifeCos. Public market measures continue to move in-line with treasuries and corporate debt.

Public CRE Cost of Debt Benchmarks vs. Treasuries



Sources: Newmark Research, Green Street as of 5/7/2024

Spreads Have Fallen Sharply, Including for Riskiest Tranches

In contrast to corporate bonds, new issue CMBS are offering wider spreads both compared with 2021 and with the pre-pandemic average across tranches. BBB/BBB- spreads have come in dramatically since mid-2023, though remain considerably wide of historical averages, suggesting that the market remains wary of distress. One factor that is helping new issues is greater faith in the accuracy of the underwriting on newer loans whereas CMBS in the secondary market were underwritten with excessively optimistic appraised values.

Average CMBS Conduit New Issuance Spreads to SOFR

Source: Trepp, Newmark Research as of 5/8/2024

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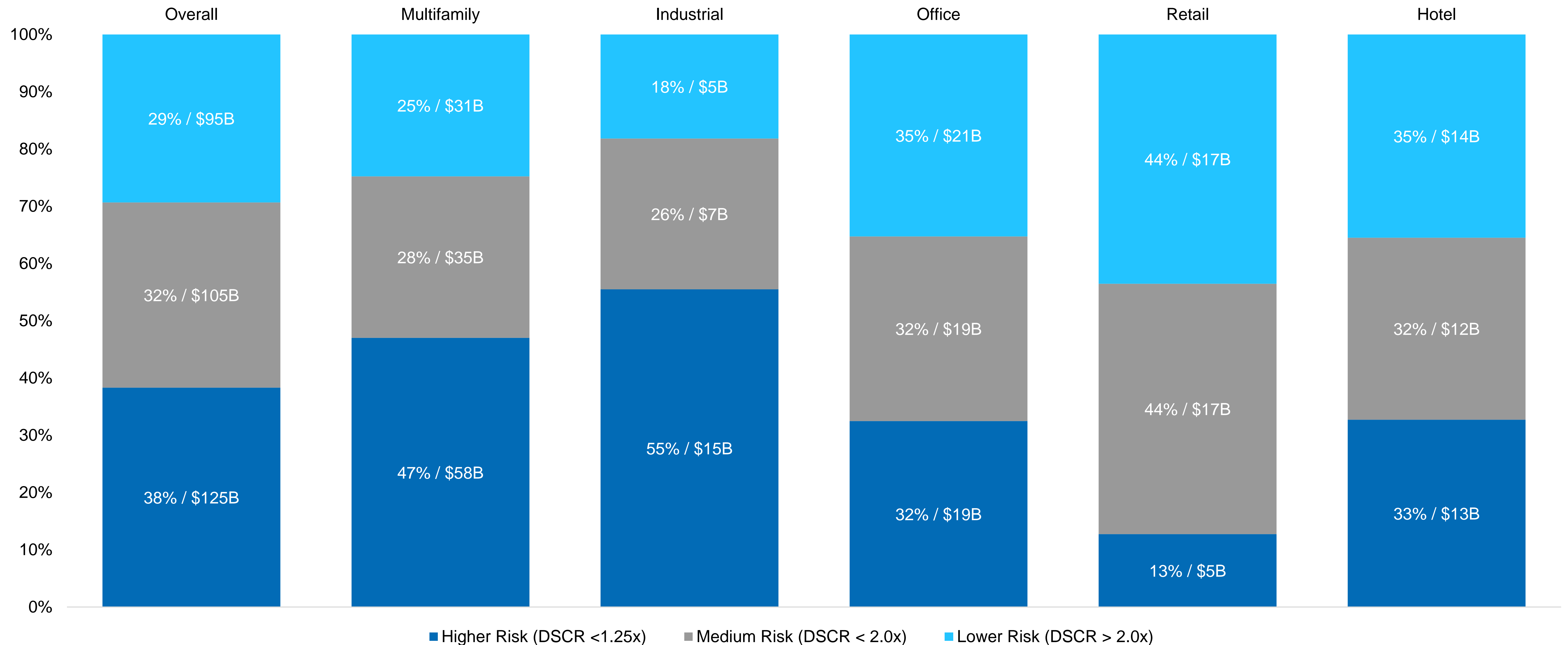
Some Loans Will Be Able to Absorb Higher Interest Costs – But Many Will Not

Even property types with strong operating fundamentals could face challenges covering new, higher interest costs. Floating rate loans on transitional product – a significant portion originated by debt funds and securitized in CRE CLO – are particularly fraught. This is largely responsible for the high portion of at-risk loans in the multifamily and industrial sectors. The securitized markets are not an isolated problem; banks engaged in a great deal of this newly risky lending. New bank regs give them a “pass” on underwater loans but not DSCRs.

DSCR Profile of Securitized CRE Debt Maturing between 2023 and 2025



Source: Trepp, Newmark Research as of 5/3/2024

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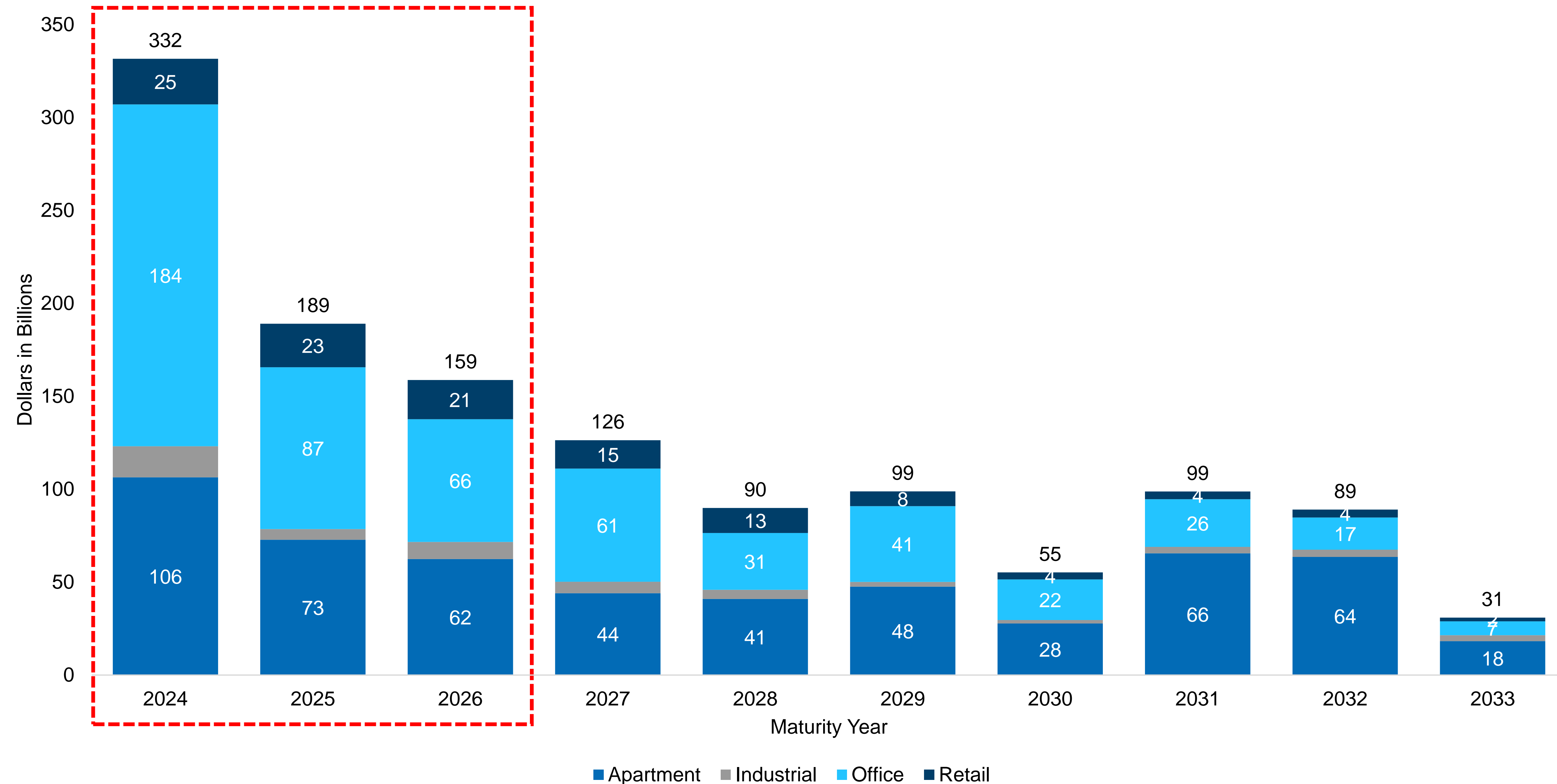
$1.3T of Outstanding CRE Debt is Potentially Troubled, $679B Maturing in '24-'26

Combining our analysis of mark-to-market LTVs with the structure of debt maturities, we estimate the volume of debt that currently is potentially troubled.* Office and multifamily loans constitute most potentially troubled loans, particularly in the 2024-to-2026 period. The high office volume results from most loans being underwater. The distribution of LTV ratios for multifamily are more favorable overall, but the greater size of the multifamily market and the concentration of lending during the recent liquidity bubble drive high nominal exposure.

Potentially Troubled Loans by Maturity Year*



Source: Green Street, NCREIF, RCA, Trepp, MBA, Newmark Research as of 4/30/2024
*Loans with an estimated senior debt LTV of 80% or greater are potentially troubled. The loans are marked-to-market using an average of cumulative changes in the Dow Jones REIT sector price indices, REIT sector enterprise value indices and Green Street sector CPPI.

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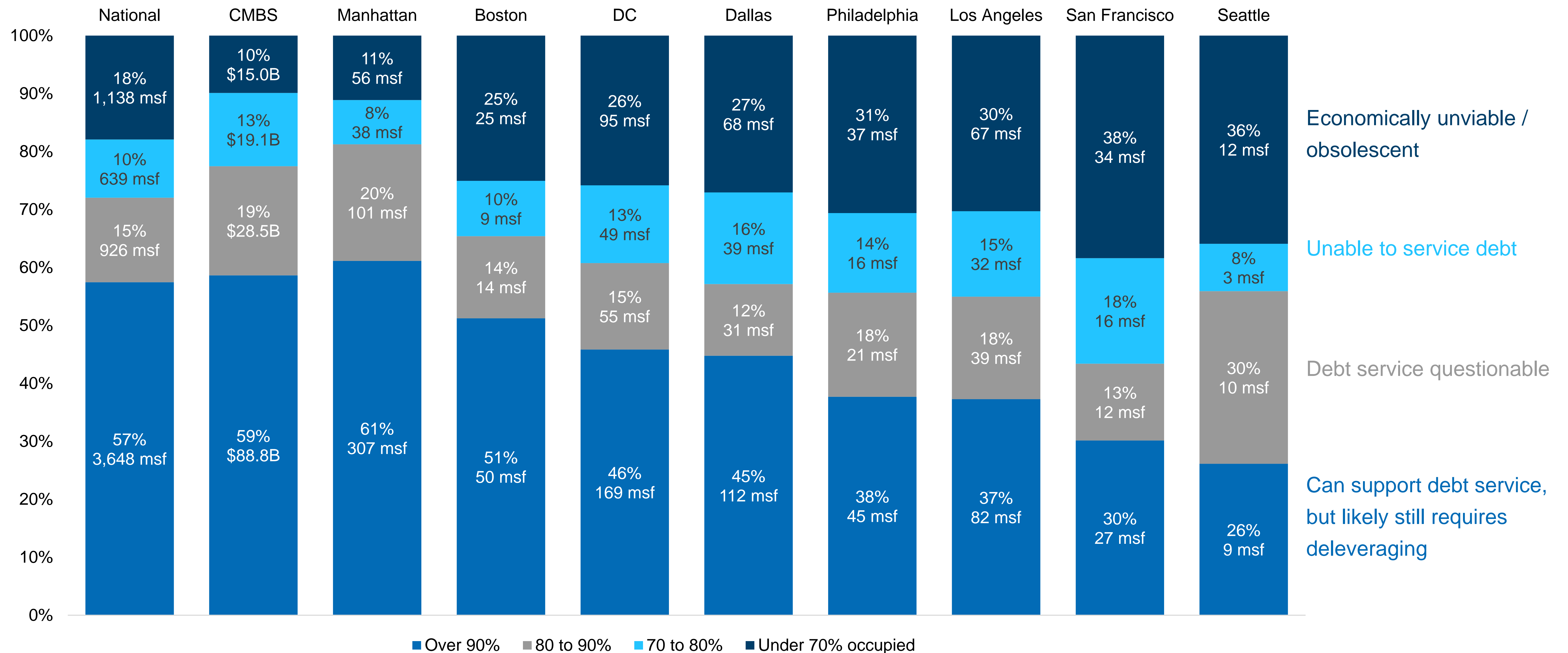
Office Vacancy Is Not Evenly Distributed within Markets, Nor Will Be Impairments

Significant portions of the office market are structurally impaired purely from an occupancy perspective. Debt issues will accelerate their demise. On the other hand, many offices have healthy occupancy profiles. While they may still be over-levered, there is a clear fundamental path to solvency.

Distribution of Office Vacancy

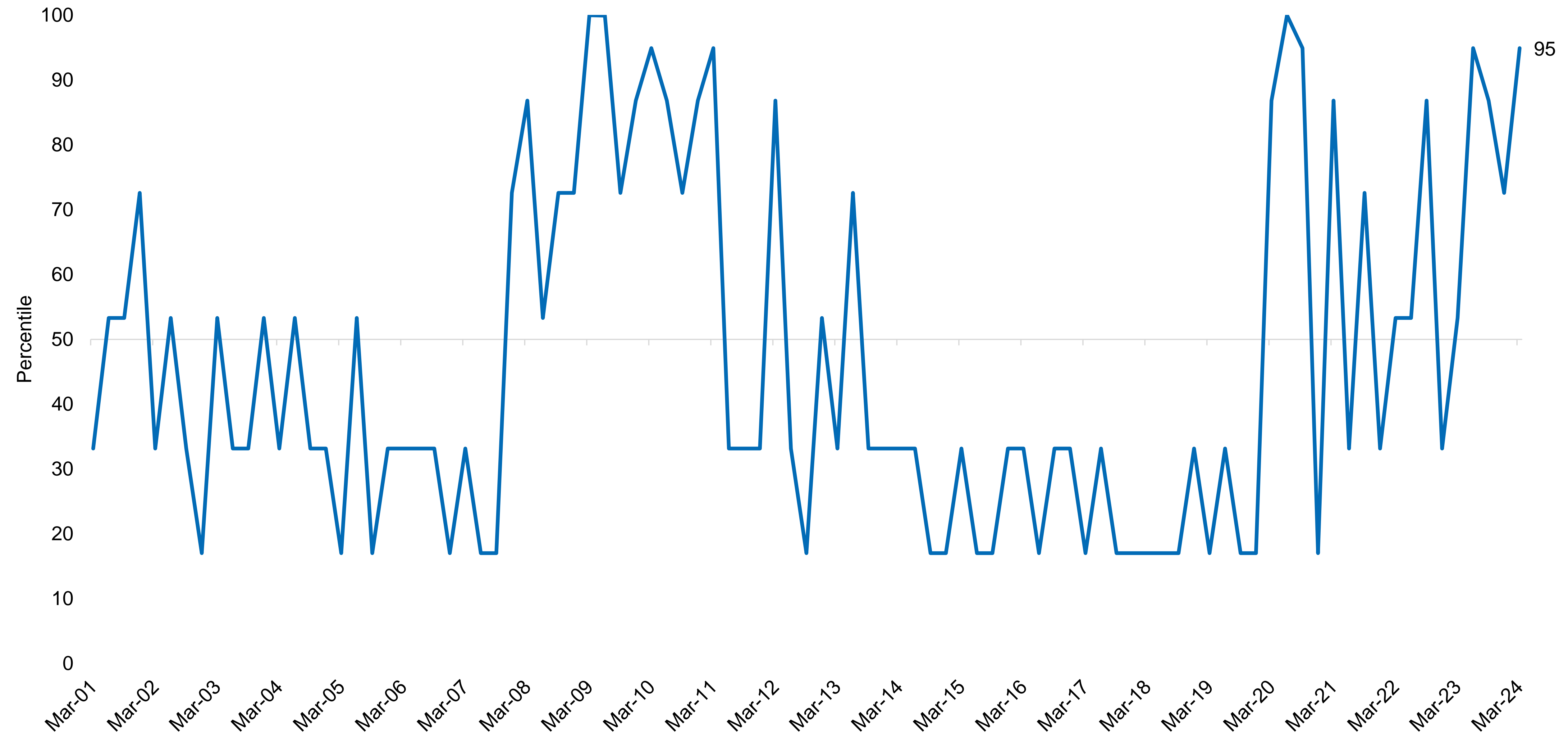


Source: Costar, Newmark Research as of 5/8/2024

Interest in Loan Sales Near Record Highs

While it is difficult to estimate the volume of loan dispositions given their opacity, interest in the topic has clearly increased, matching the levels seen in mid-2020 and during the GFC.

CRE Loan Sales Story Frequency*



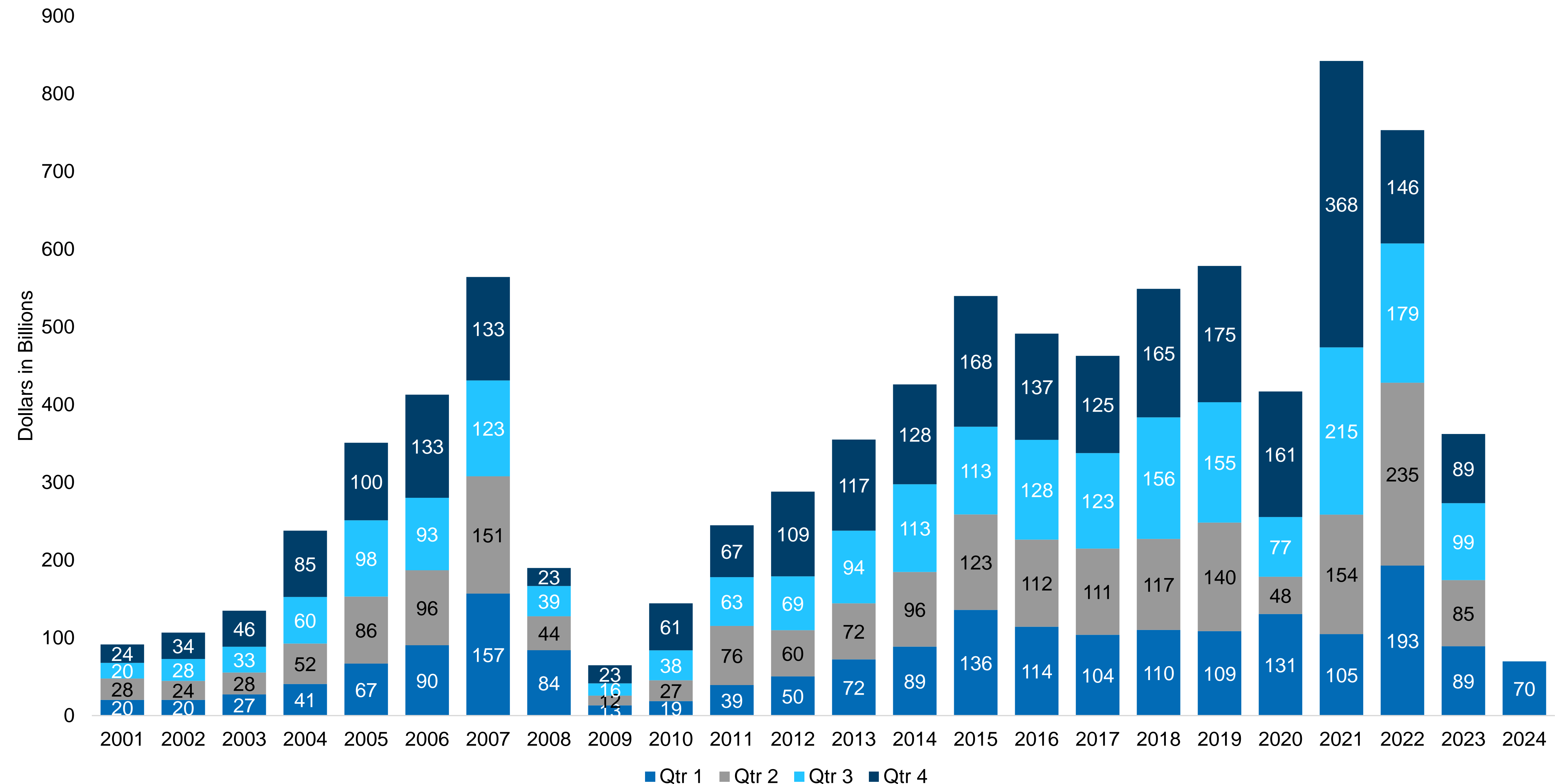
Source: Green Street, Newmark Research as of 5/15/2024
*Based on Commercial Mortgage Alert and Real Estate Alert stories that mention loan sales. Percentile calculated using on normal sampling distribution.

Equity Capital Markets

Sales Activity Remained Anemic in 1Q24, Slowest First Quarter Since 2012

Sales declined 22% year-over-year in 1Q24 and negative 35% compared with the 2017-to-2019 average. This represents a modest improvement compared to 4Q23 which was down 43% relative to the 2017-to-2019 average. There had been some expectation of a pickup in sales activity following improvement in debt market conditions in late 4Q23, but this did not materialize as the window snapped shut amid once more rising yields. Extend and pretend strategies continue to impede sales activity, but this strategy is precarious.

Investment Sales Volume

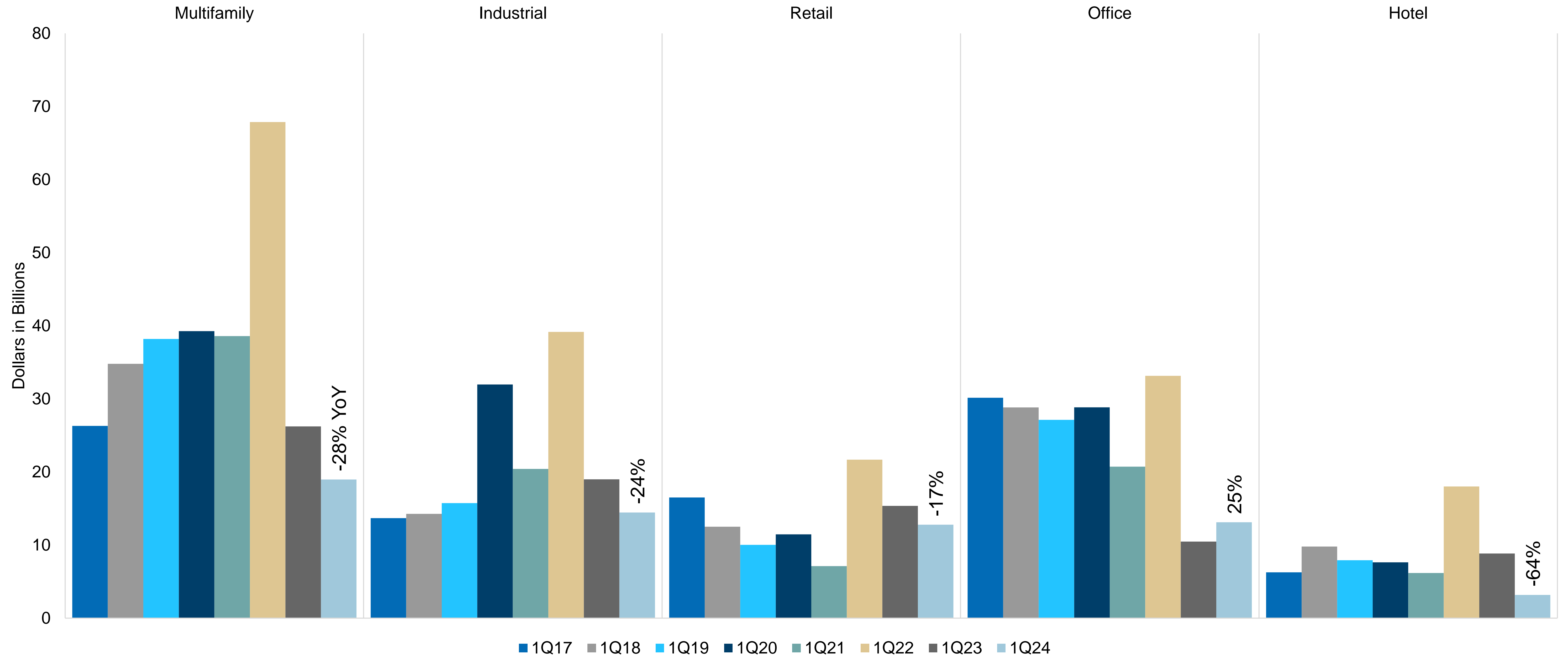


Source: RCA, Newmark Research as of 4/26/2024

Transaction Activity Broadly Declined Year-over-Year in 1Q24

Hotel sales declined most sharply both year-over-year and compared with the 2017-to-2019 average. Multifamily and industrial sales also saw year-over-year declines, though industrial sales were just 1% behind the 2017-to-2019 average whereas multifamily sales were down 43%. Office showed signs of life – up 25% year-over-year but still down 54% from pre-pandemic.

Investment Sales Volume

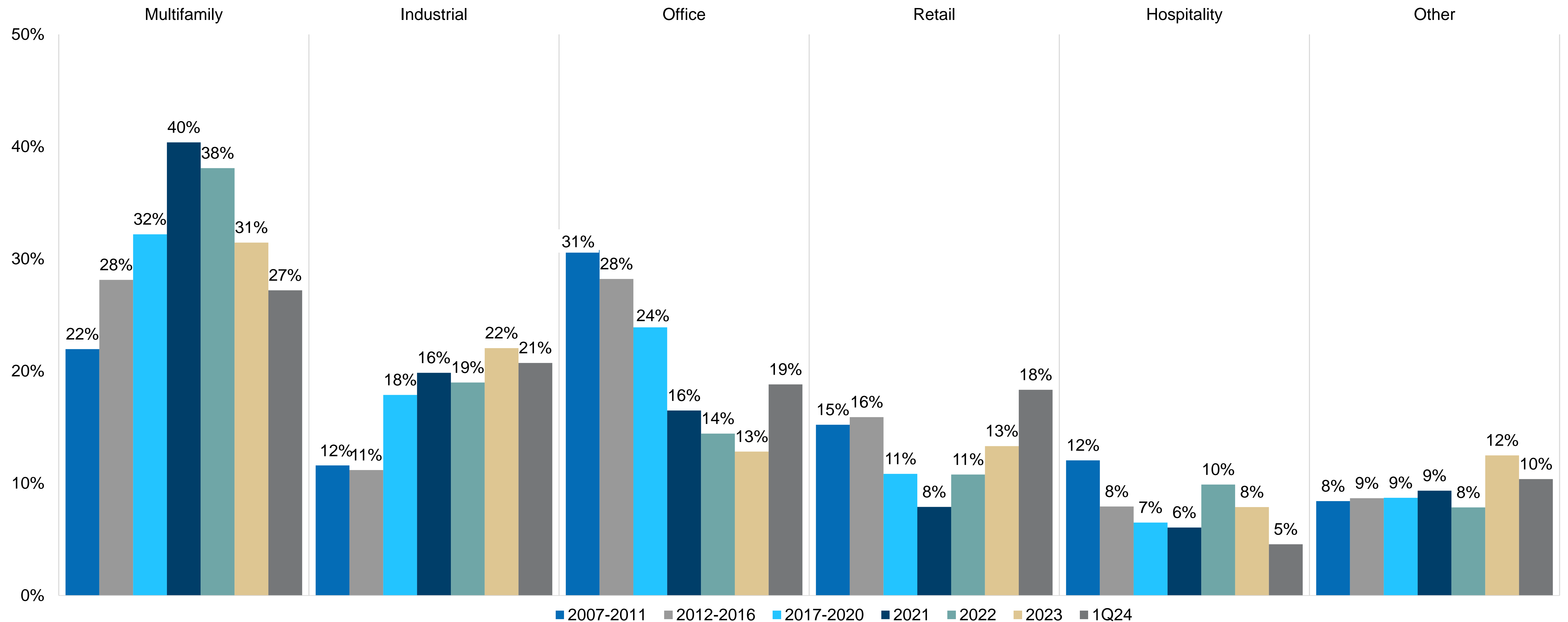


Source: RCA, Newmark Research as of 4/26/2024

Transaction Activity Continues to Rebalance with Retail Share Rising in Particular

The multifamily share of investment sales fell sharply in 2023, returning to 2017-to-2020 levels. In early 2024, this negative momentum continued. In contrast, the retail share has been rising consistently since bottoming in 2021 and has continued to gain share in 1Q24 even eclipsing its average share in the 2012-to-2016 period. The office share rebounded sharply in the first quarter, but it is too soon to say whether this represents a new trend. The industrial share has been relatively steady and remains above its pre-pandemic level.

Investor Allocation over Time

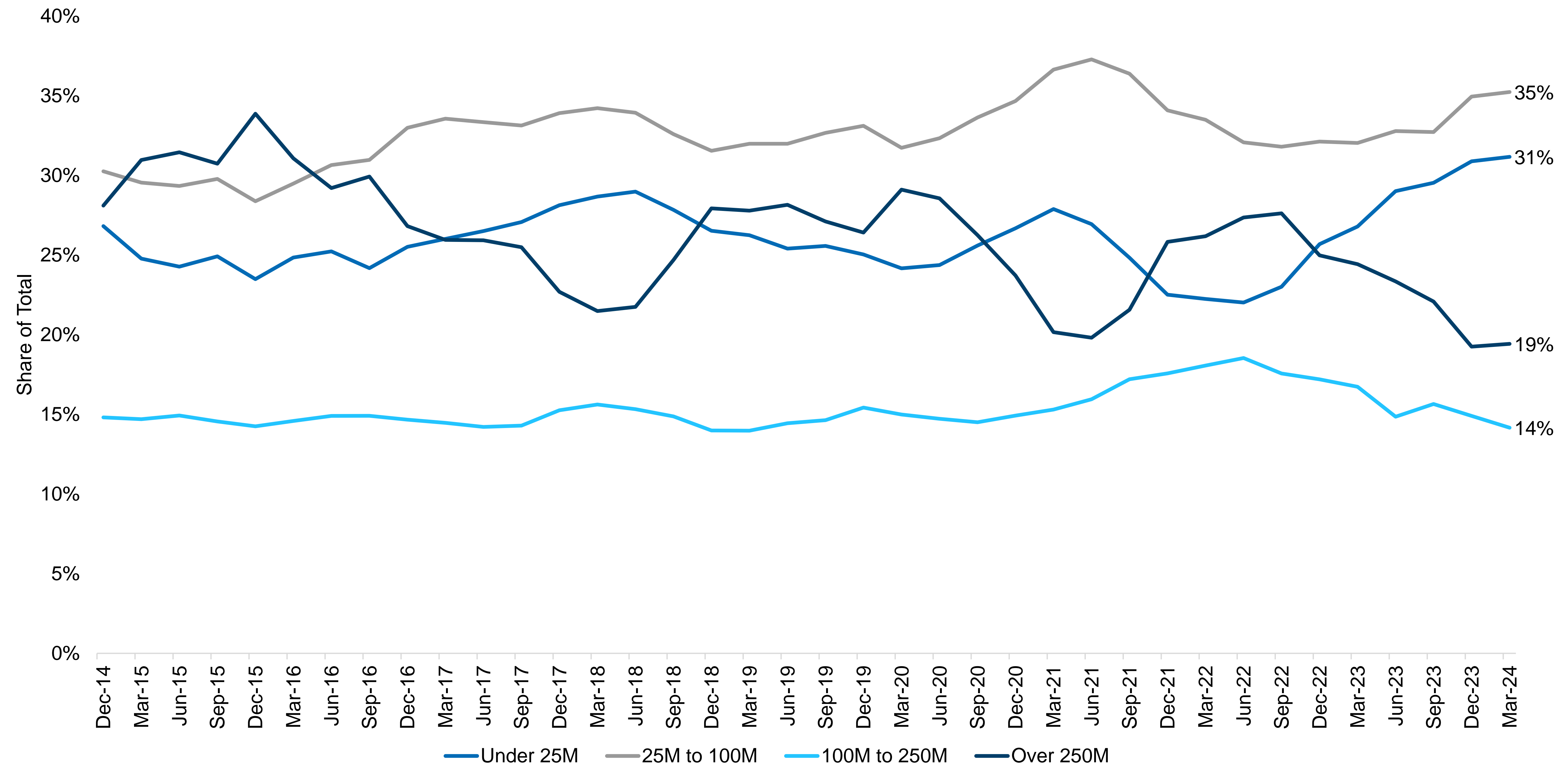


Source: Real Capital Analytics, Newmark Research as of 4/26/2024
Note: "Other" includes development sites, senior housing and nursing care, self storage, parking and manufactured housing.

Liquidity Has Shifted Towards Smaller Deals

Deals under $100M accounted for 66% of investment sales volume in the last four quarters as compared with a long-term average of 59%. The sharpest increase has been in deals under $25M, which are their highest since 2010. On the other hand, the share of deals over $250M have declined sharply to just 19%, though they continue to outnumber the volume of deals in the $100M-to-250M range. These trends are interrelated with the decline in the institutional share of sales activity in favor of smaller, private capital buyers.

Rolling 4-Quarter Investment Sales Volume by Deal Size



Source: RCA, Newmark Research as of 4/26/2024

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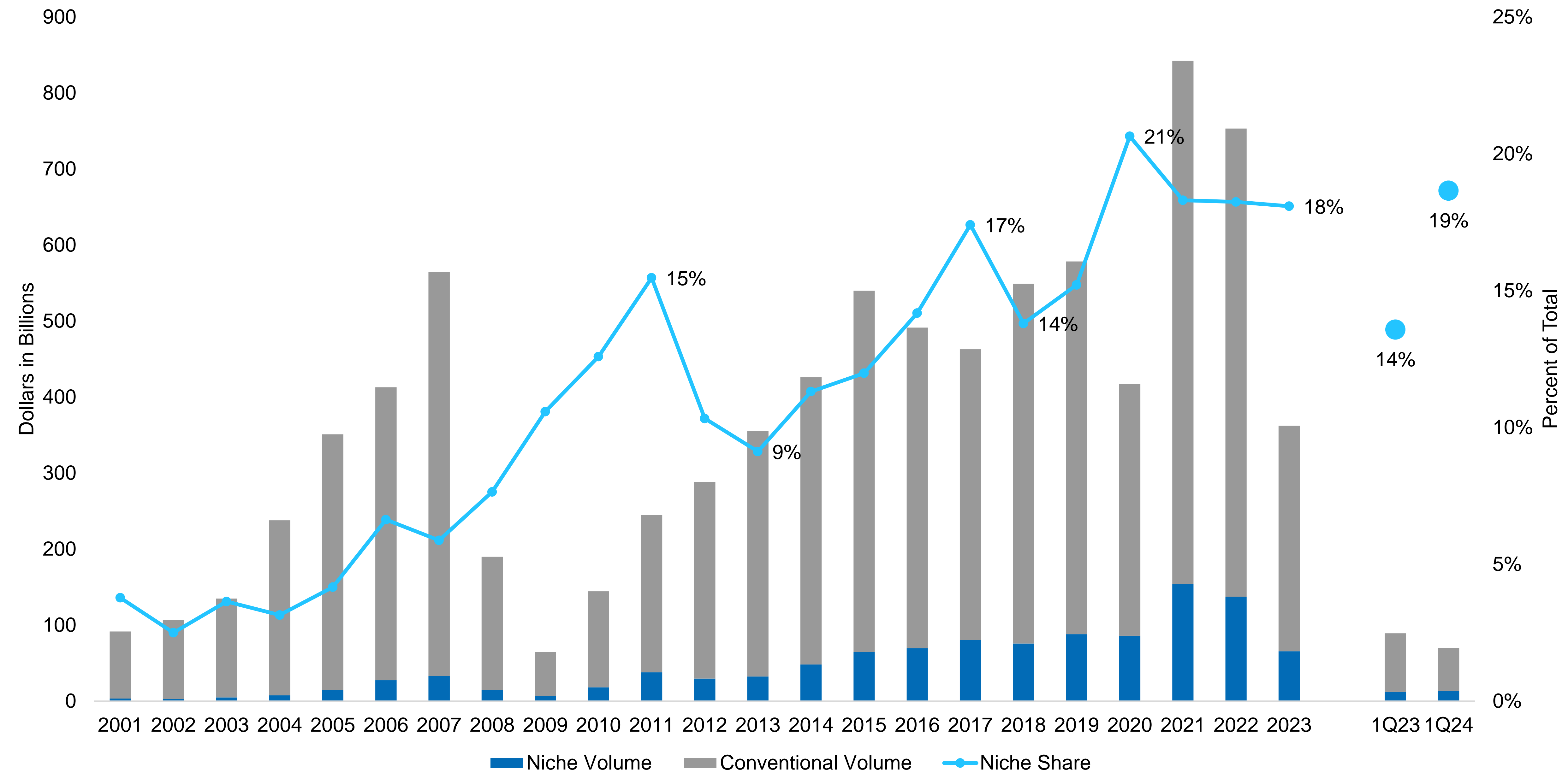
Niche Sector Volumes Increase 8% Year-over-Year in 1Q24

Niche sector acquisitions outperformed conventional on a year-over-year basis as the latter was down 26%. Niche investment also outperformed relative to the 2017-to-2019 baseline, down 25% in 1Q24. As a result, the niche investment share rose to 19%, slightly above the 2023 level of 18%. The niche asset share while down from it's 2020 peak remains at historically high levels. This is supported by increasing institutional interest in niche asset categories as reflected in rising shares in ODCE funds.

Investment Sales Volume



Source: RCA, Newmark Research as of 4/26/2024

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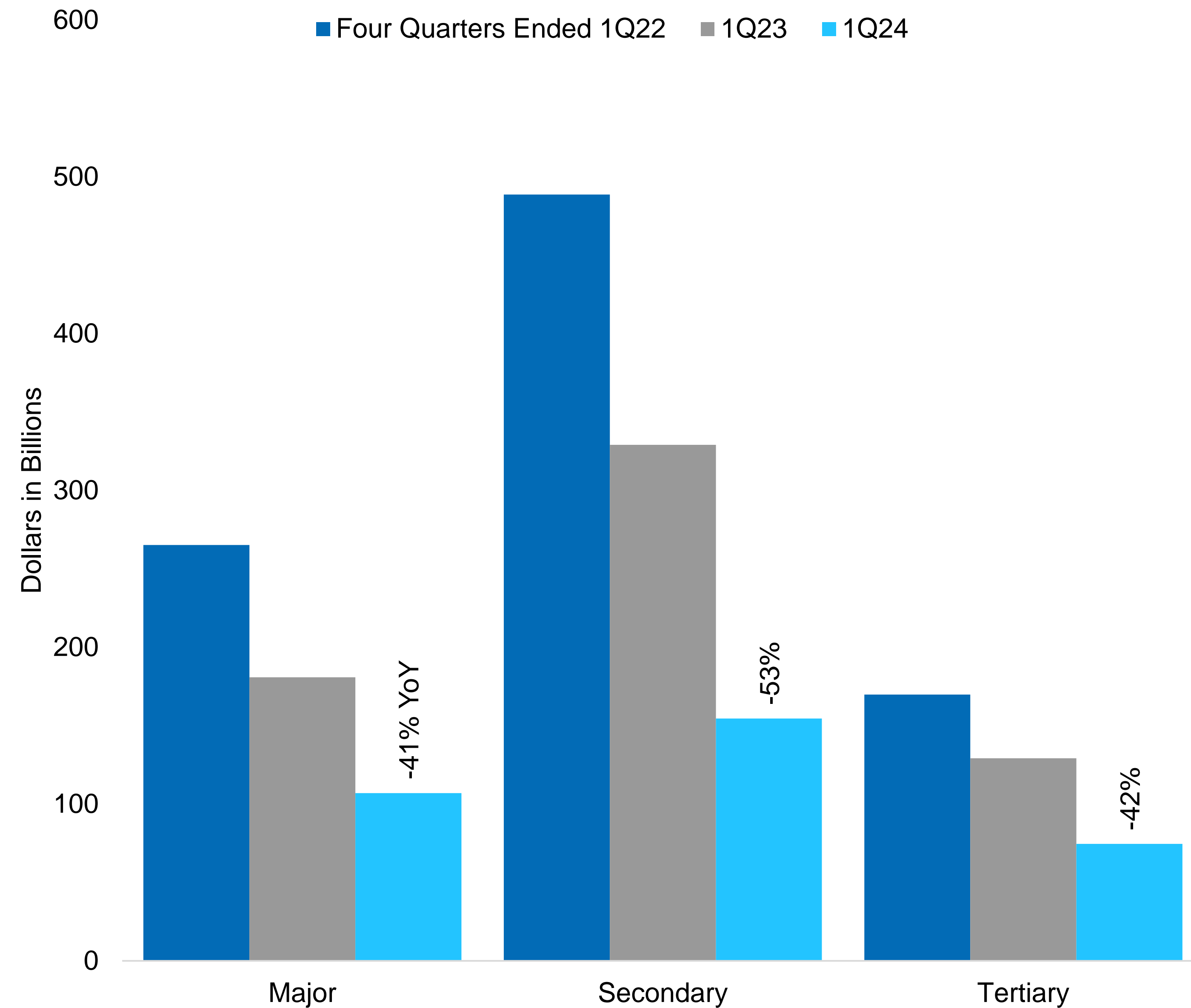
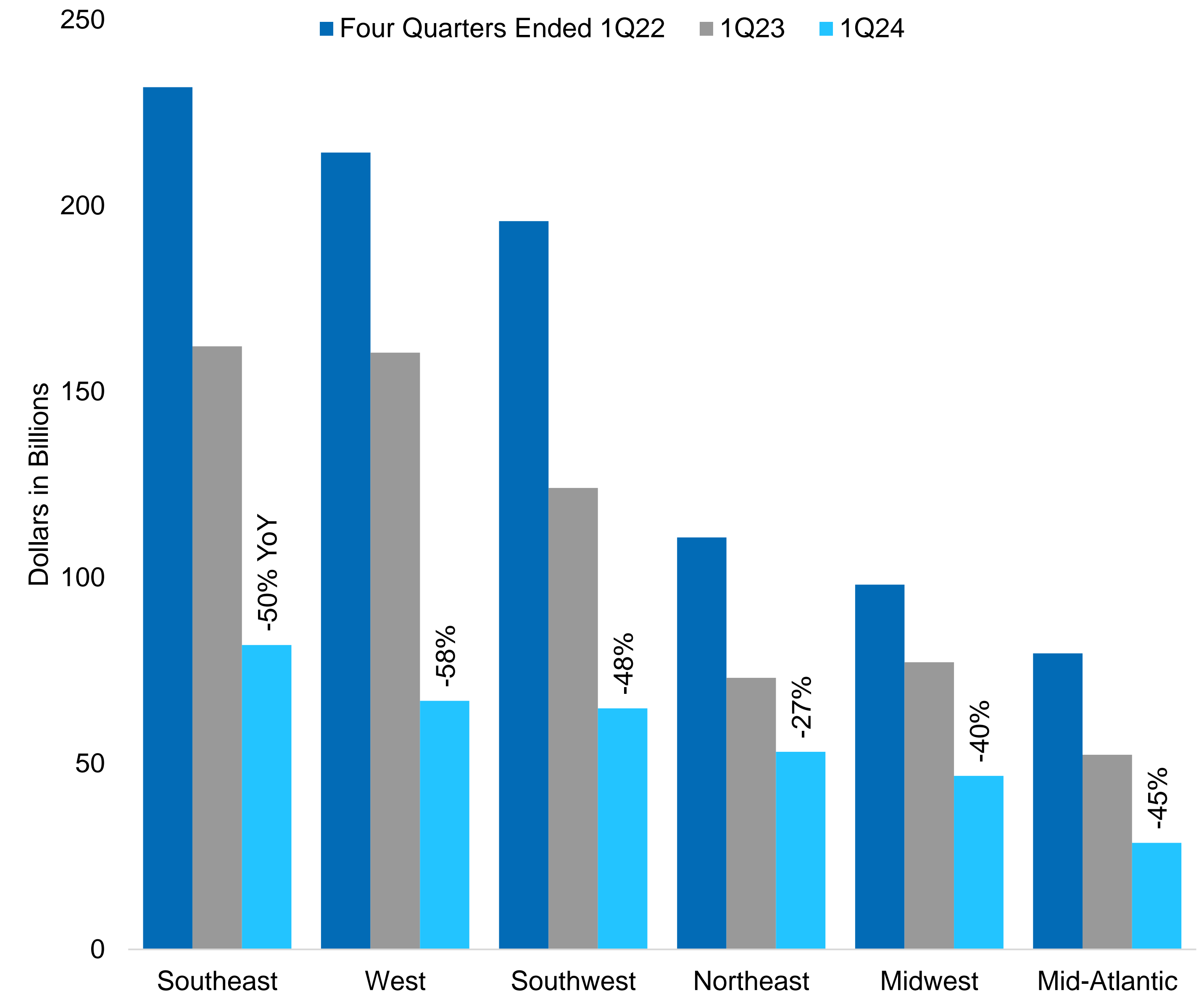
Sales Volume Continues to Fall Sharply across Market Tiers and Regions

Against this negative backdrop, major and tertiary markets have been moderately less impacted. The West and Southeast regions were the most liquid overall, while the Midwest and Northeast contracted least year-over-year.

Investment Sales Volume by Market Tier



Investment Sales Volume by Region

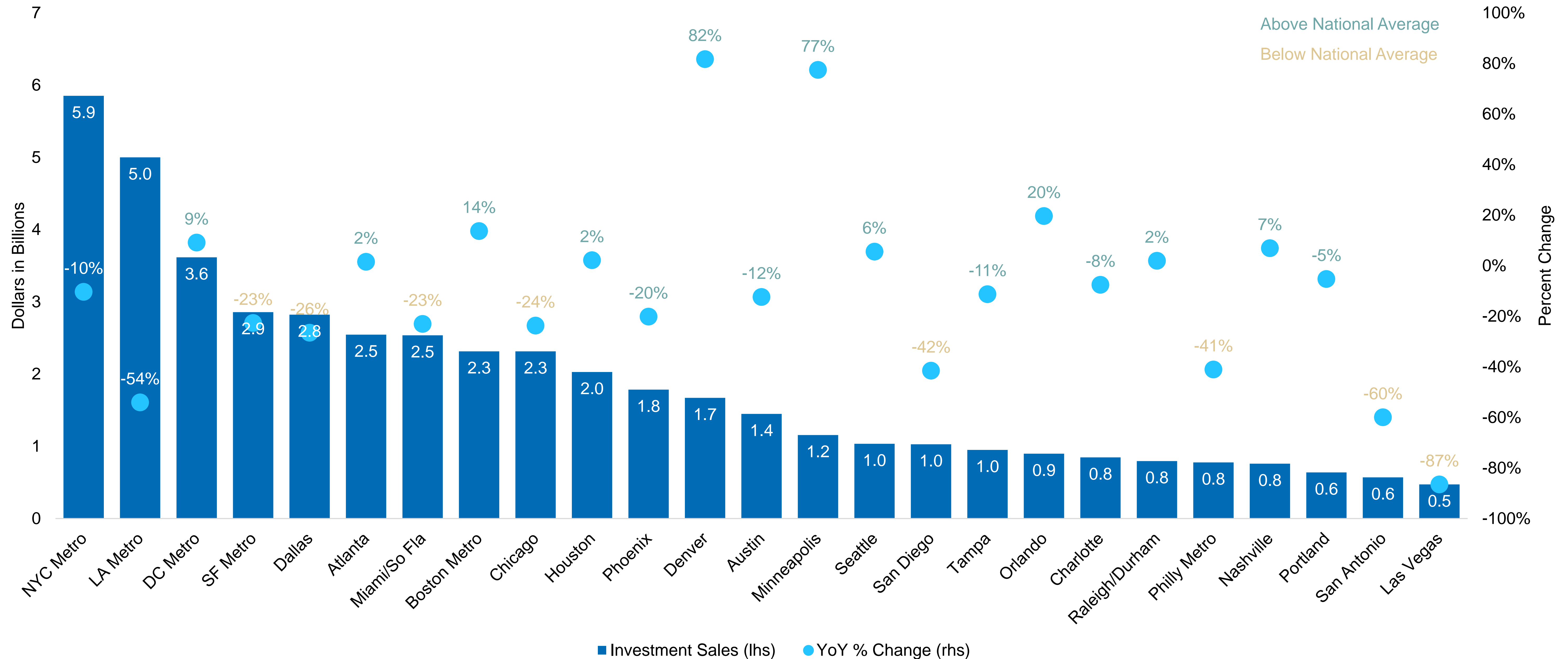


Source: RCA, Newmark Research as of 4/26/2024

Investment Sales Increased Year-over-Year in 10 out of 25 Top Metros in 1Q24

NYC Metro and LA Metro were the top markets by investment volume in the US in 1Q24. Volumes declined year-over-year in all the top 25 metros in 2023, but 1Q24 is off to a more favorable start. 10 out of 25 recorded higher investment sales volumes compared with a year ago, notably Denver, Minneapolis, Orlando and Boston. While volume was down 22% nationally, 16 of the top 25 markets by volume outperformed.

Top 25 Metro Markets by 1Q24 Volume

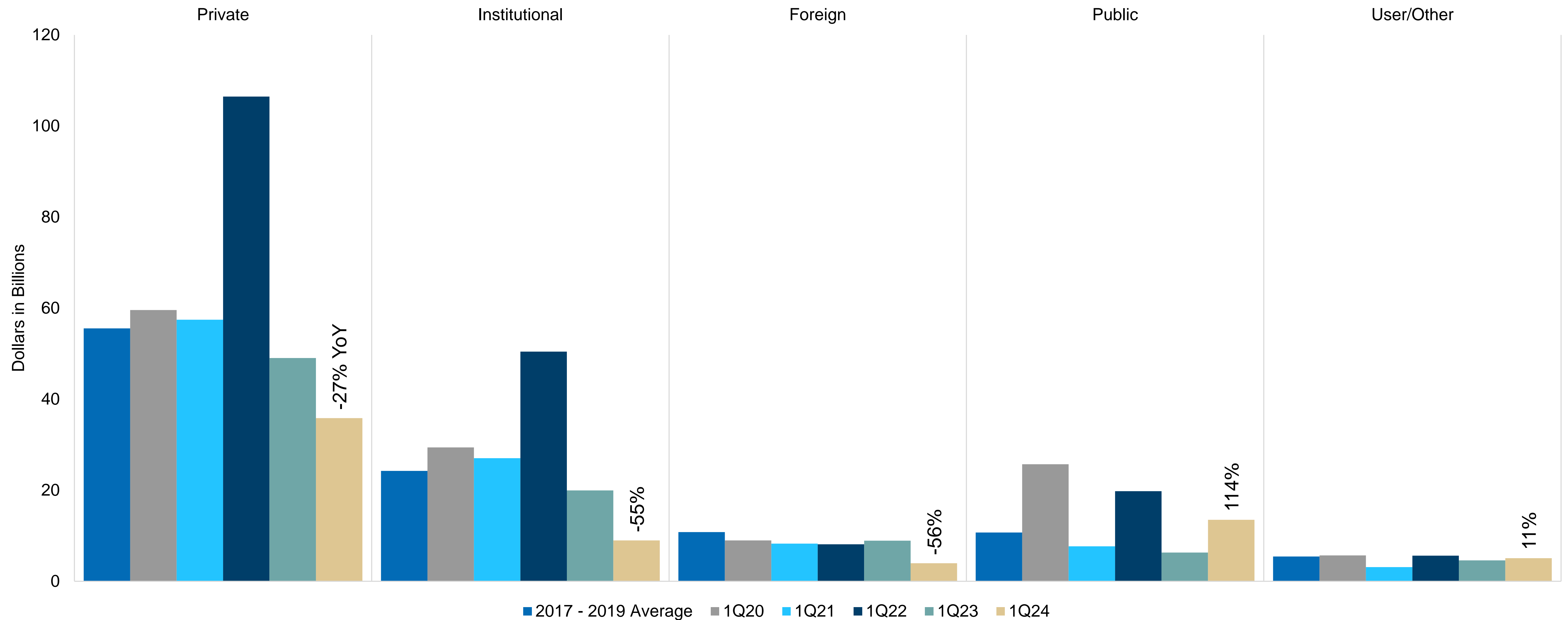


Source: RCA, Newmark Research as of 4/26/2024
Note: Excludes tertiary markets from ranking.

Public Vehicle Acquisitions Helped Offset Weak Investment by Institutions

Private capital remains the most active segment, accounting for 51% of acquisitions. Institutions deployed 55% less capital compared with 1Q23 and 63% vs. the 2017-to-2019 average. Foreign investment also continued to decelerate; these investors face additional constraints in the form of a strong dollar and elevated hedging costs. Public vehicle acquisitions increased sharply, but it is too soon to declare this is a trend. Occupiers increased acquisitions potentially seeing opportunity in the void left by other groups.

Acquisitions Volume by Capital Group



Source: RCA, Newmark Research as of 4/26/2024

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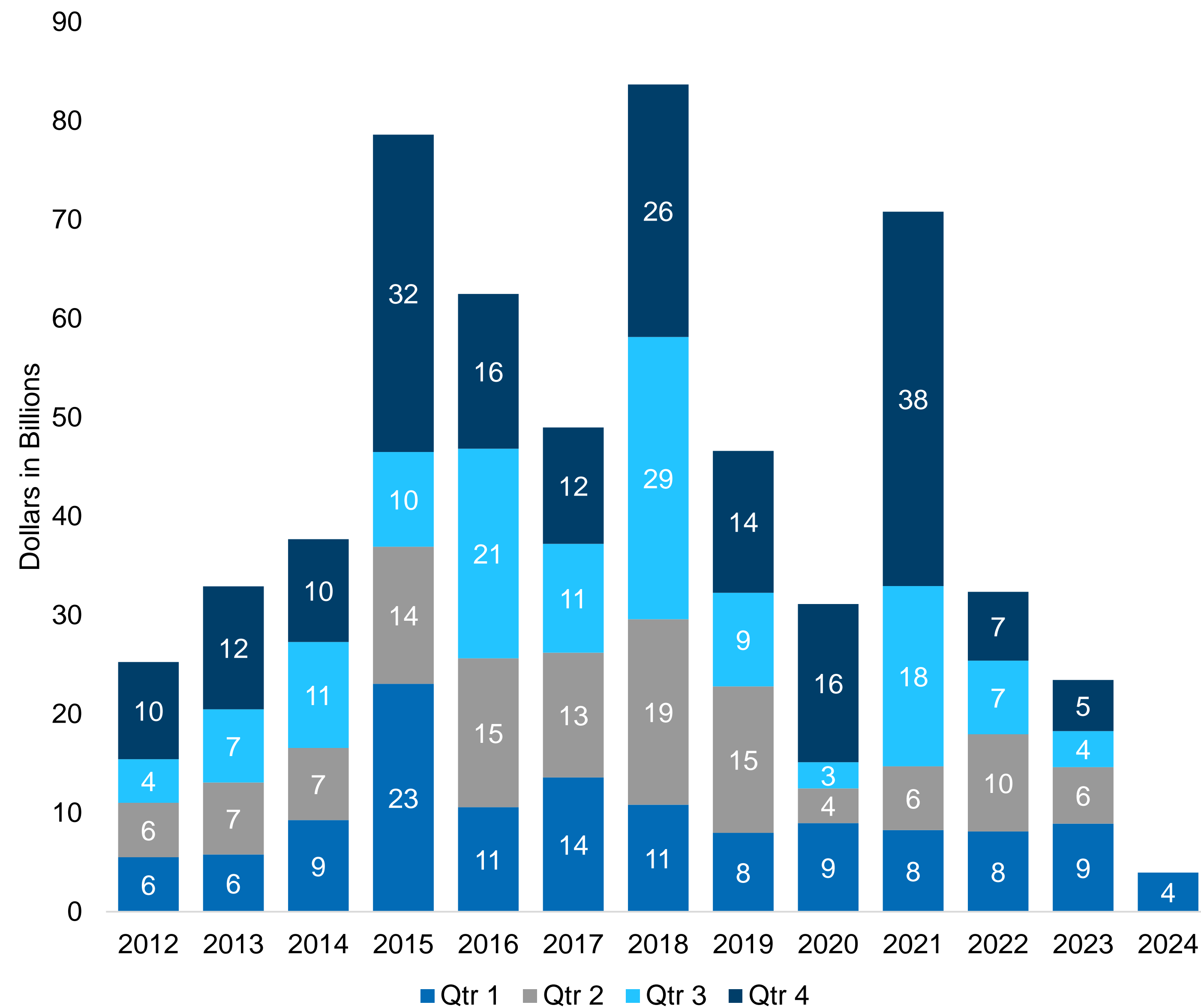
Foreign Investment Declined 56% Year-over-Year in 1Q24

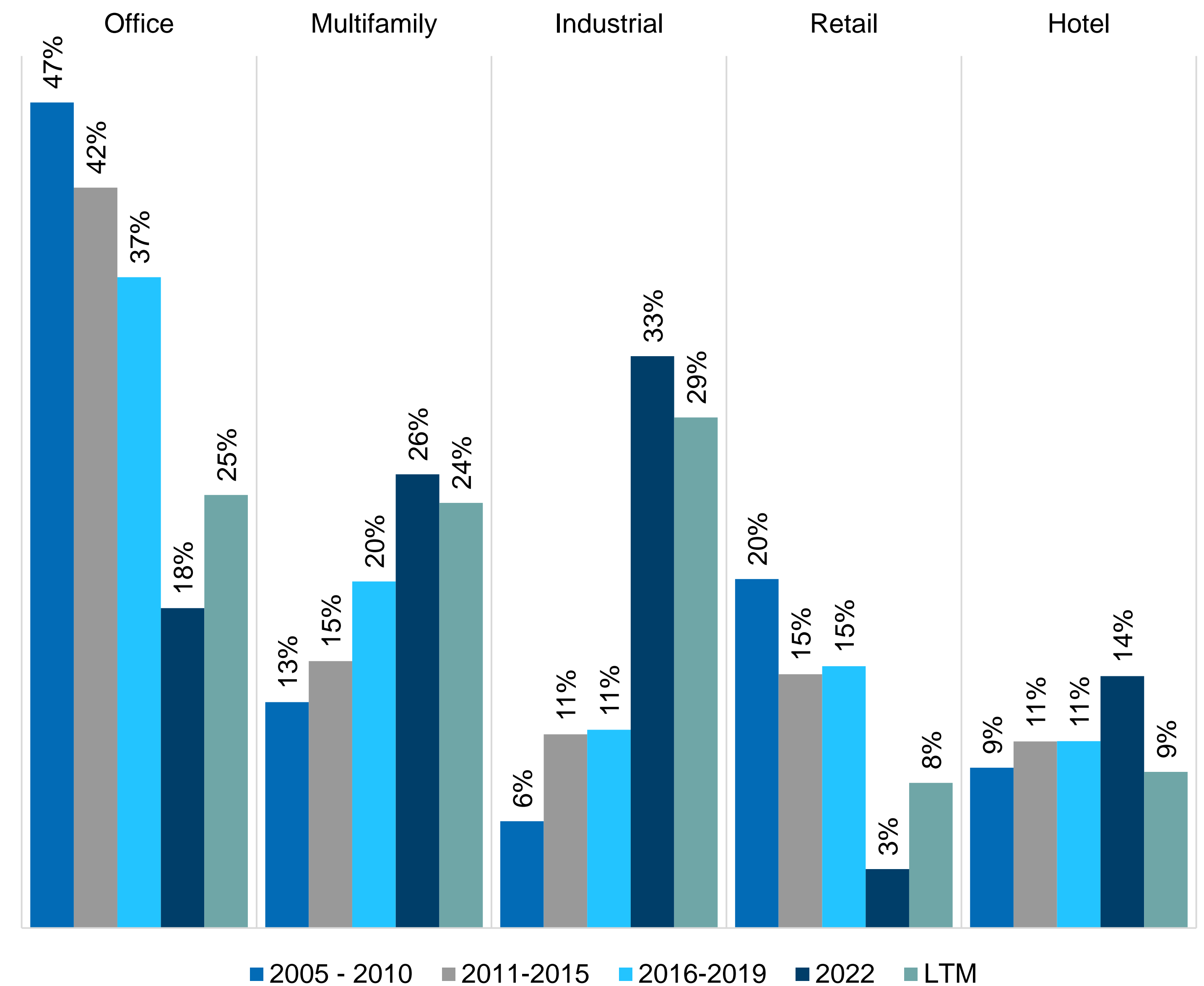
Foreign investment was at its lowest ebb since 3Q22 or since 2011 for a first quarter. The foreign share of investment 5.6%, well below the 8.3% long-term quarterly average. Looking at the last 12 months, industrial constitutes the largest share of foreign investment and, while down from 2022, is still materially above pre-pandemic levels. The same is true of multifamily, albeit less dramatically. The office and retail shares of foreign investment have rebounded in the same period though still below pre-pandemic.

Cross-Border Acquisitions Volume



Year	Qtr 1	Qtr 2	Qtr 3	Qtr 4
2012	6	6	4	10
2013	6	7	7	12
2014	9	7	11	10
2015	23	14	10	32
2016	11	15	21	16
2017	14	13	11	12
2018	11	19	29	26
2019	8	15	9	14
2020	9	4	3	16
2021	8	6	18	38
2022	8	10	7	7
2023	9	6	4	5
2024	4			

Allocation of Cross-Border Acquisitions



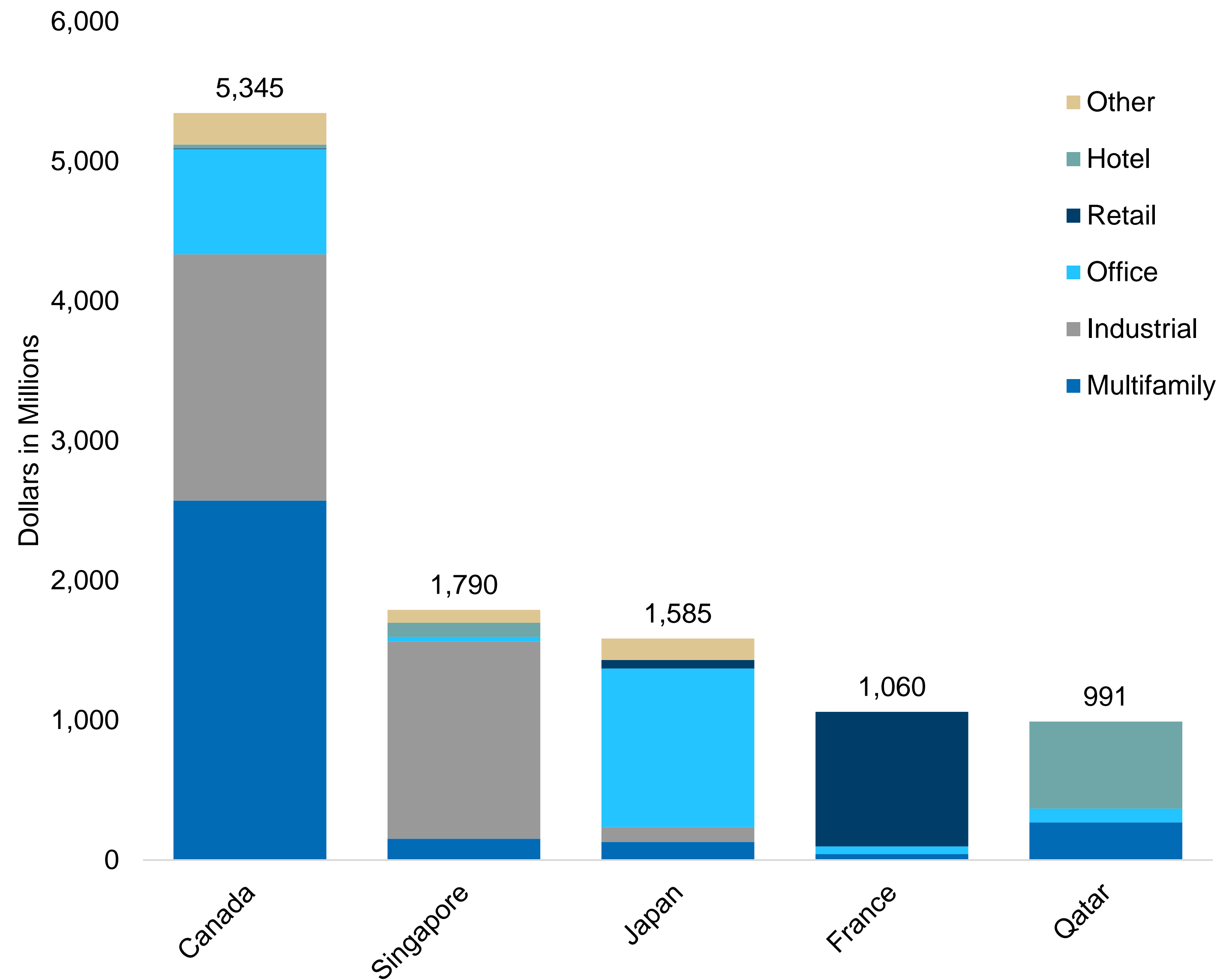
	2005 - 2010	2011-2015	2016-2019	2022	LTM
Office	47%	42%	37%	18%	25%
Multifamily	13%	15%	20%	26%	24%
Industrial	6%	11%	11%	33%	29%
Retail	20%	15%	15%	3%	8%
Hotel	9%	11%	11%	14%	9%

Source: Newmark Research, Real Capital Analytics as of 4/26/2024

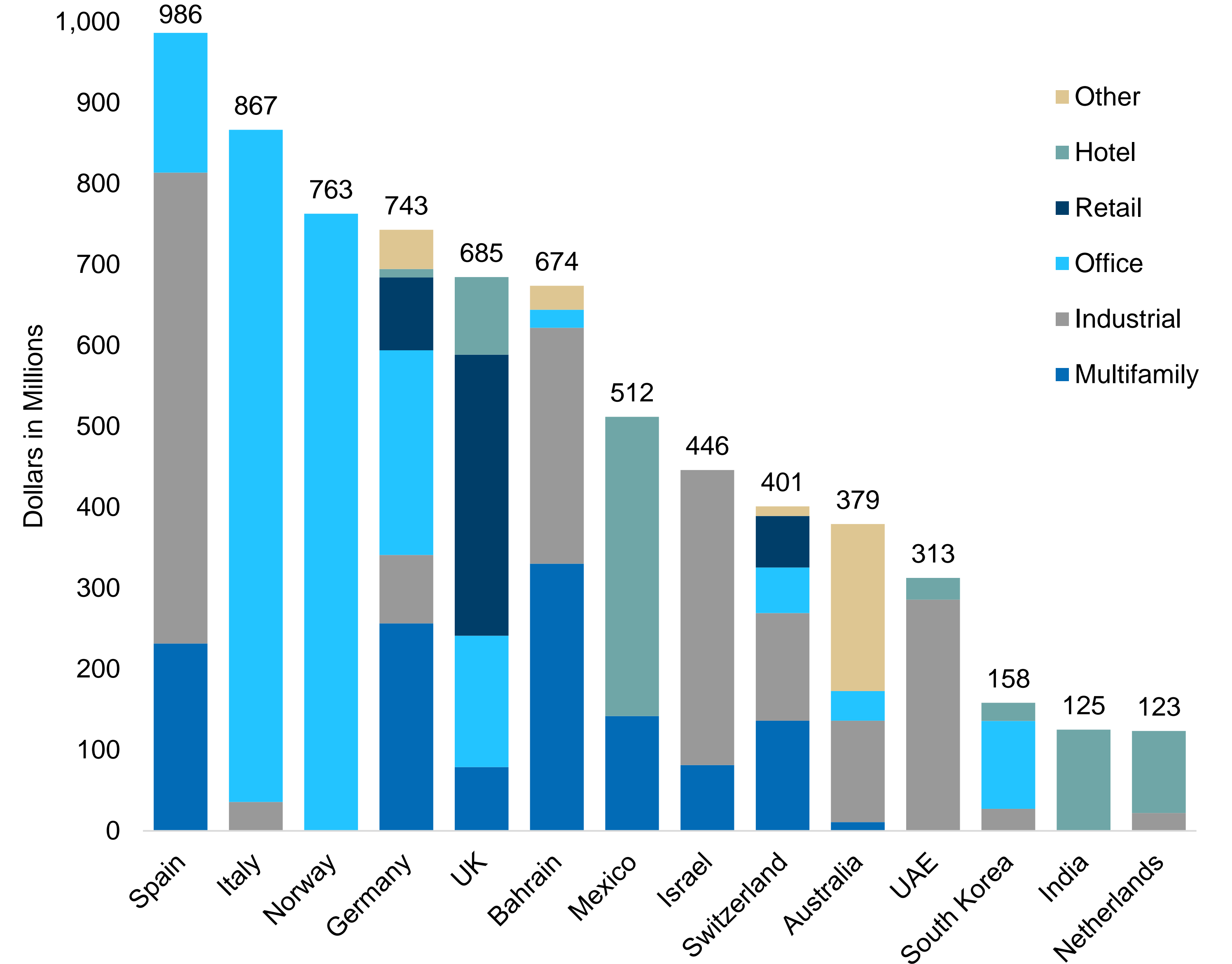
Sources of Inbound Capital

Canada, per usual, led inbound investment in the last 12 months with a pronounced focus on industrial and multifamily investment. Singapore followed, concentrated on industrial. After Singapore came Japan, France and Qatar. Japan, Italy, and Norway stood apart in having relatively high office investment.

Top Five Sources of Inbound Capital: 2023 YTD



Remaining Sources of Inbound Capital: 2023 YTD



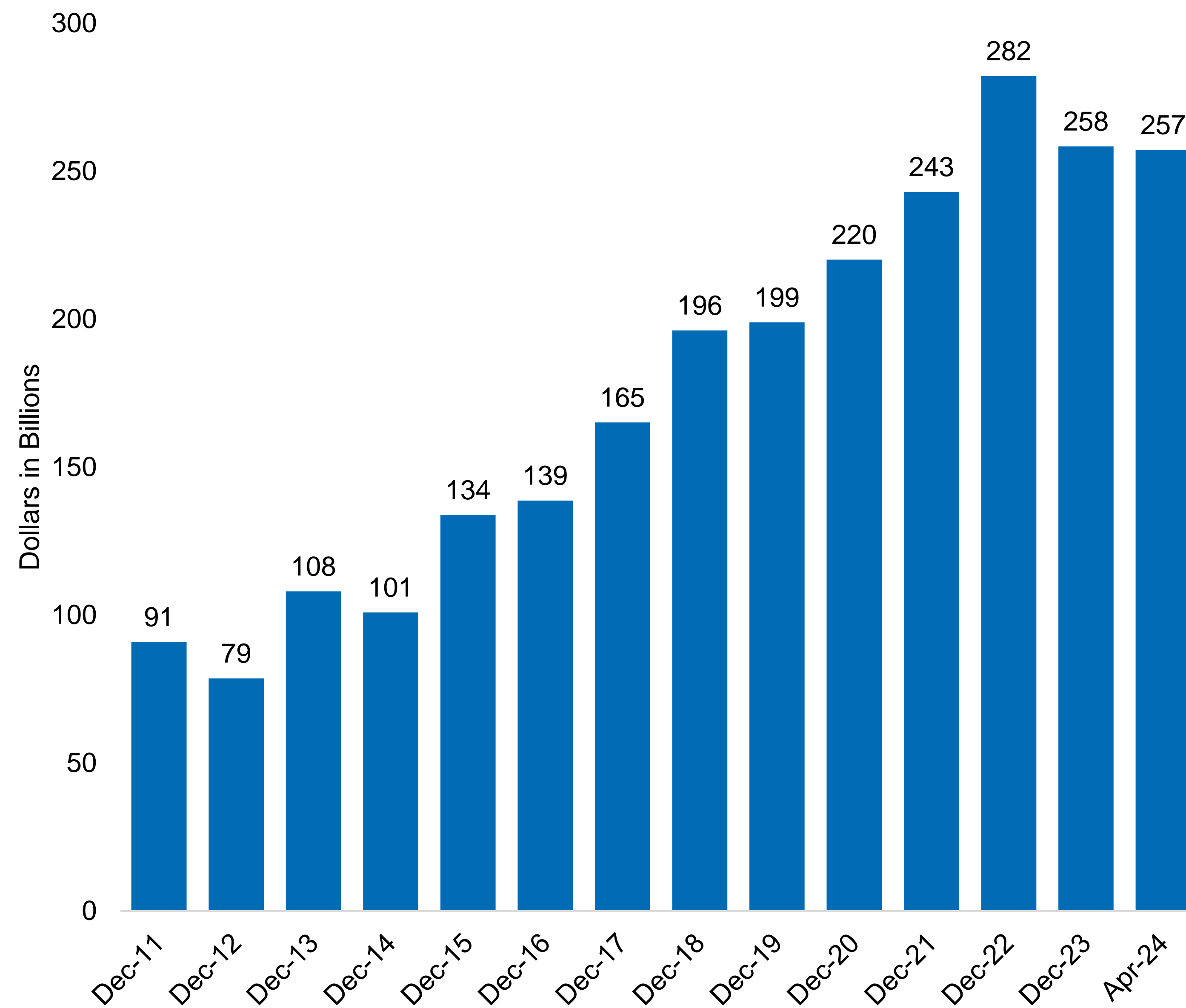
Source: RCA, Newmark Research as of 4/26/2024

Supply of Capital

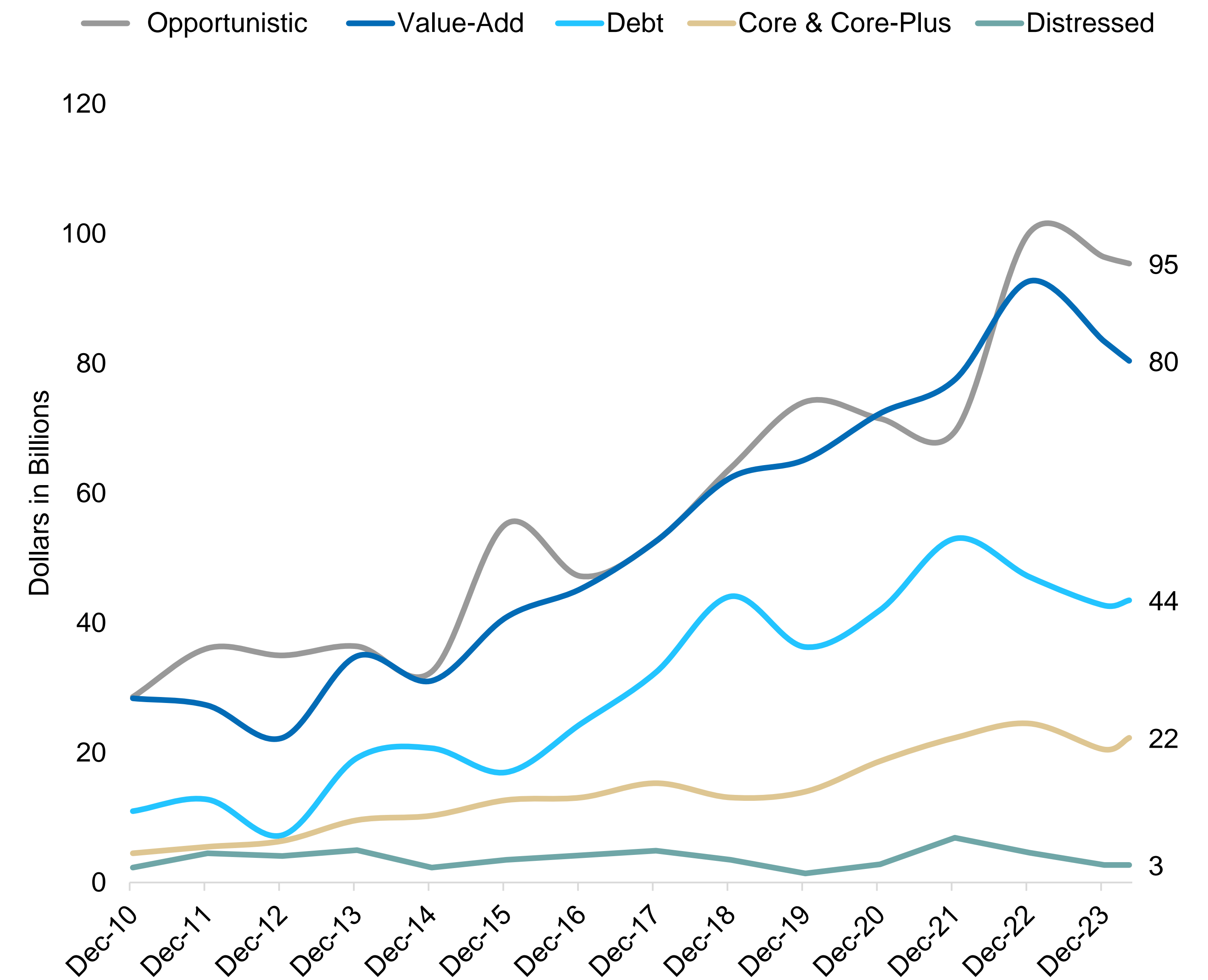
Private Equity Dry Powder Has Declined from 2022 Peak, But Still Elevated Overall

Dry powder at closed-end funds is 9% below its December 2022 peak, reflecting declines in dry powder at value-add and debt funds. Opportunistic fund vehicles are also off the peak but by a smaller margin. New fundraising declined sharply from $140B in 2022 to $105B in 2023. More positively, 1Q24 fundraising was flat QoQ at $22B and up significantly compared with 1Q23 ($11B). The number of funds raising capital has declined even more sharply and concomitantly average fund sizes have increased.

Dry Powder – Closed-End Funds



Dry Powder by Strategy*



Source: Newmark Research, Preqin as of 4/30/2024
*Not shown: Fund of funds, co-investments, and secondaries strategies

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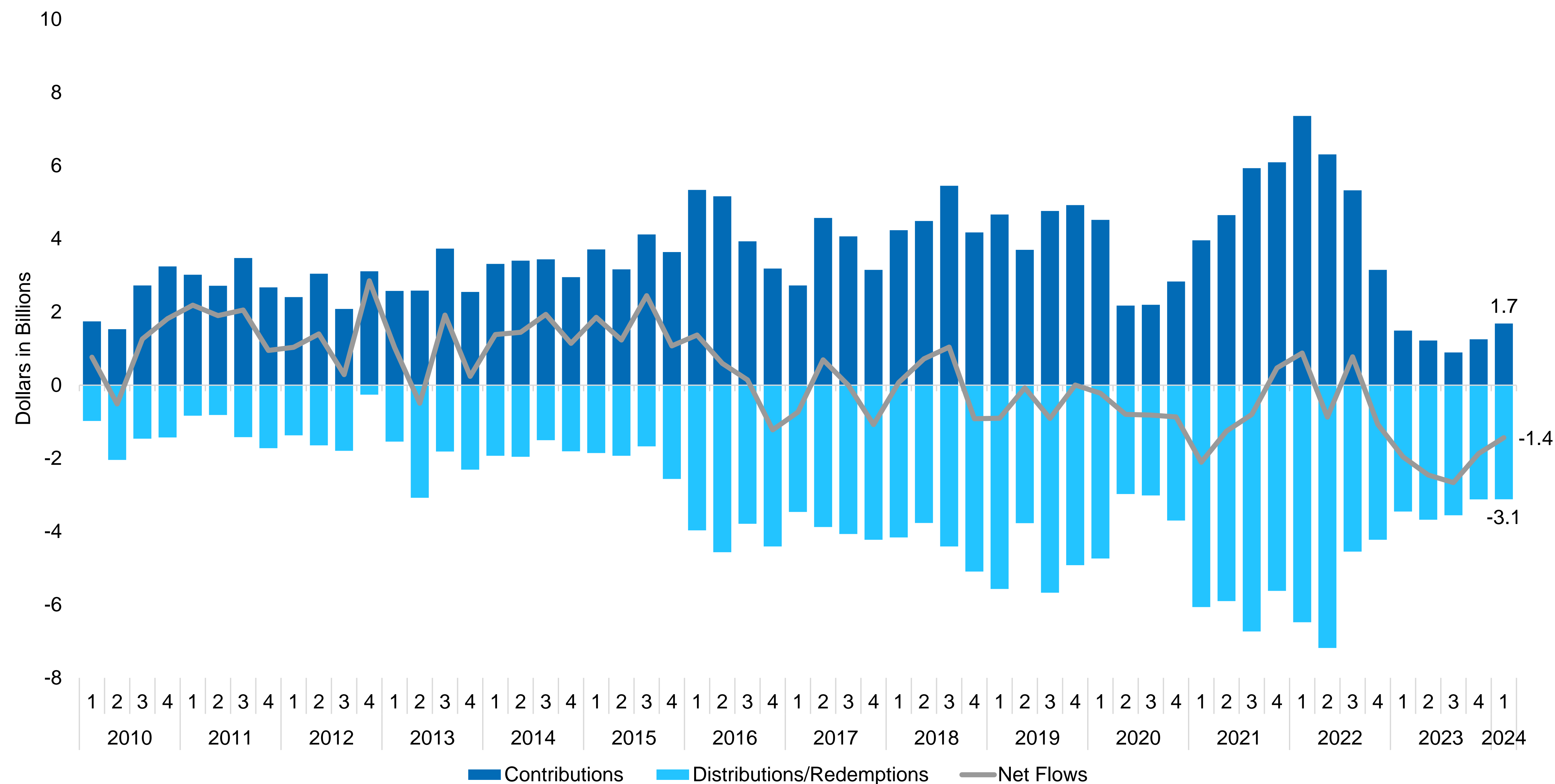
ODCE Fund Flows Remain under Pressure, But Contributions Rising

ODCE funds continued to hemorrhage cash for the sixth consecutive quarter in 1Q24. Net cash flow continued to improve due to rising contributions. Redemption queues remain an issue for a variety of funds as asset write-downs proceed methodically but have not yet converged with market values. The lack of dry powder presents fund managers with a predicament as it constrains their ability to take advantage of market dislocations.

ODCE Fund Flows

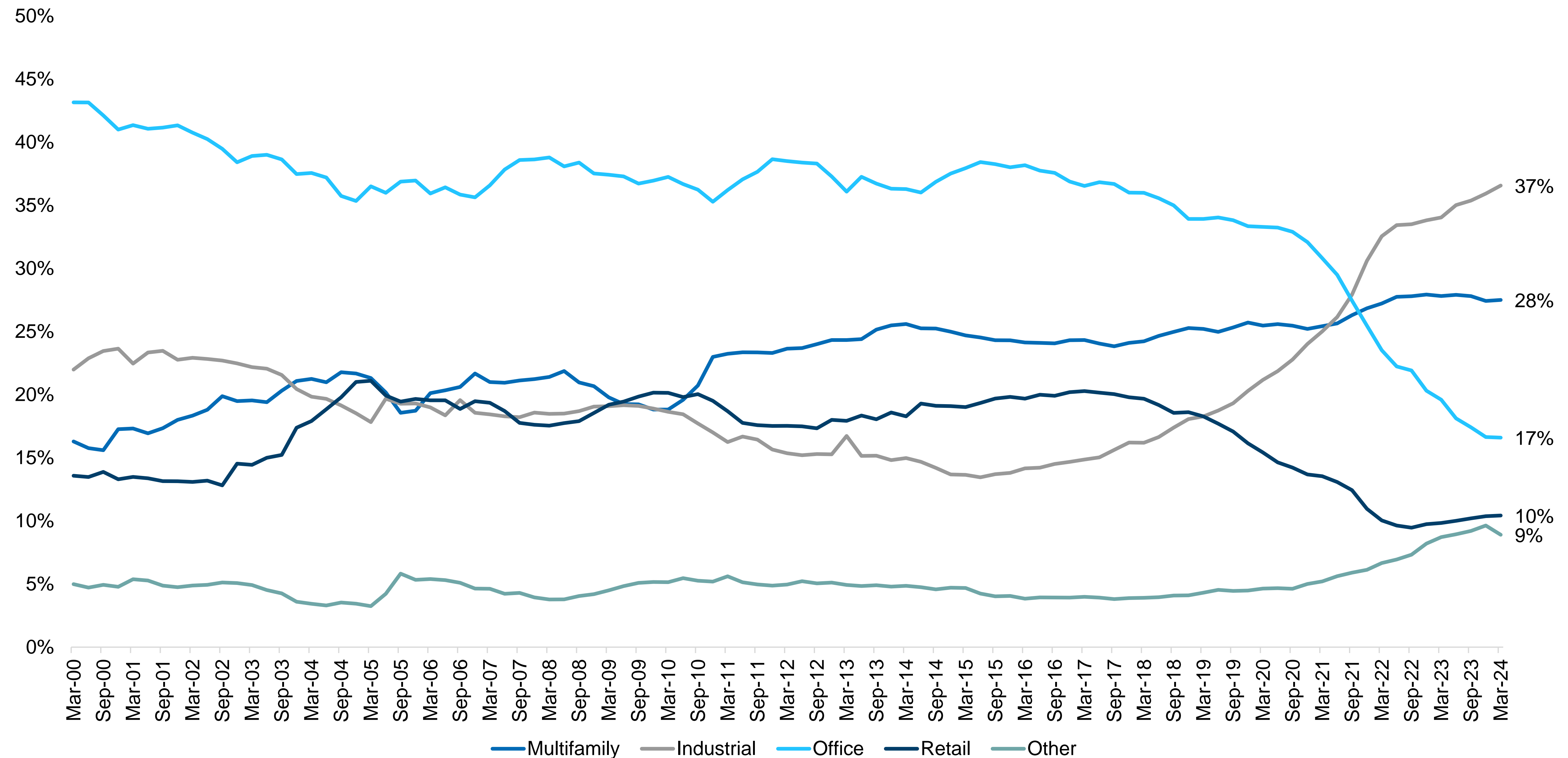


Source: Newmark Research, NCREIF as of 5/15/2024

ODCE Has Undergone an Industrial Revolution

In recent years, industrial has emerged as the dominant property type within the ODCE fund universe. This has occurred through a combination of reducing office holdings both by property count and by holding value in absolute terms and even more so relative to industrial. While industrial values have been written down since 3Q22, the number of properties held by ODCE funds has remained steady and greater write-downs in office have driven the industrial share still higher.

ODCE Value-Weighted Property Allocation

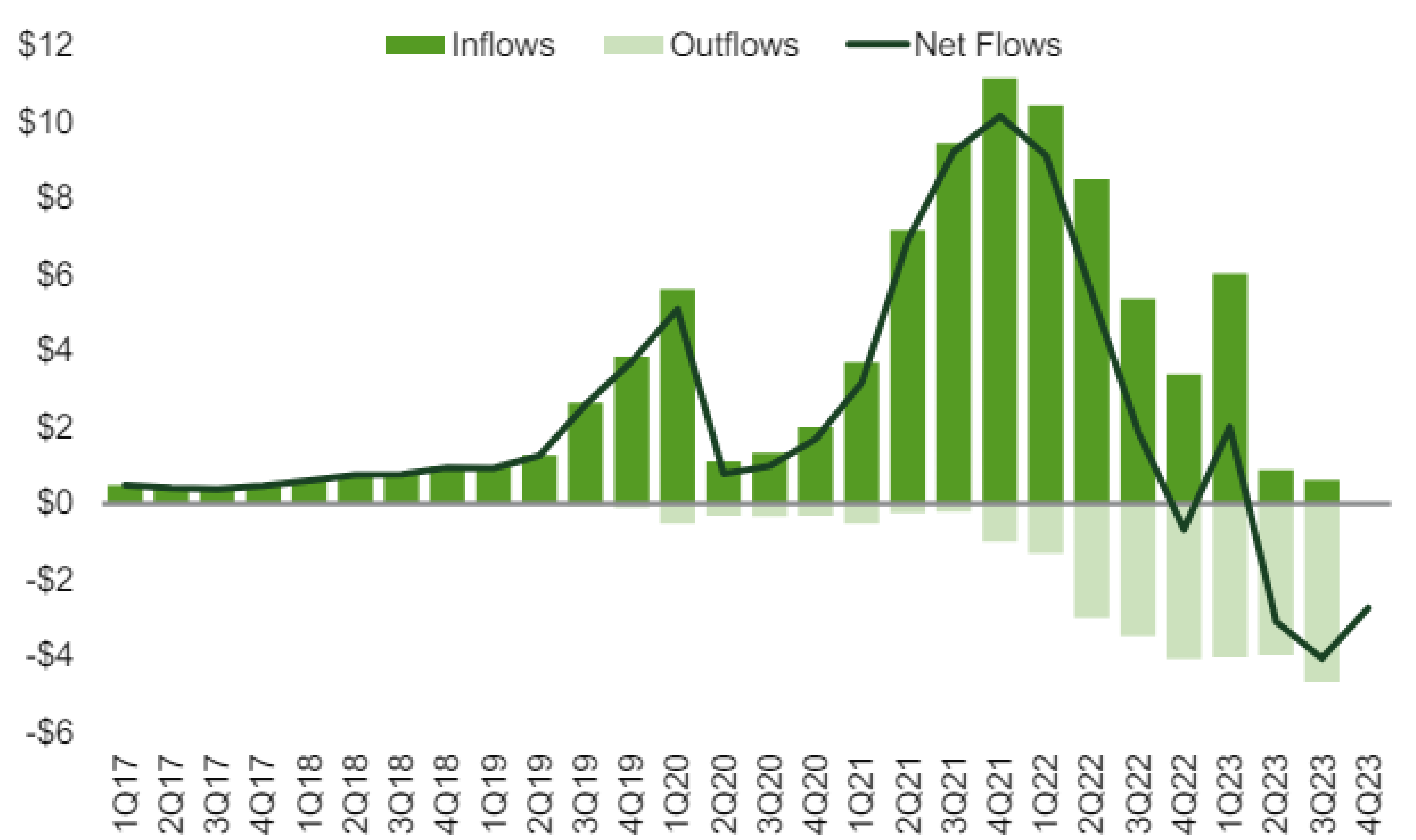


Source: NCREIF, Newmark Research as of 5/15/2024

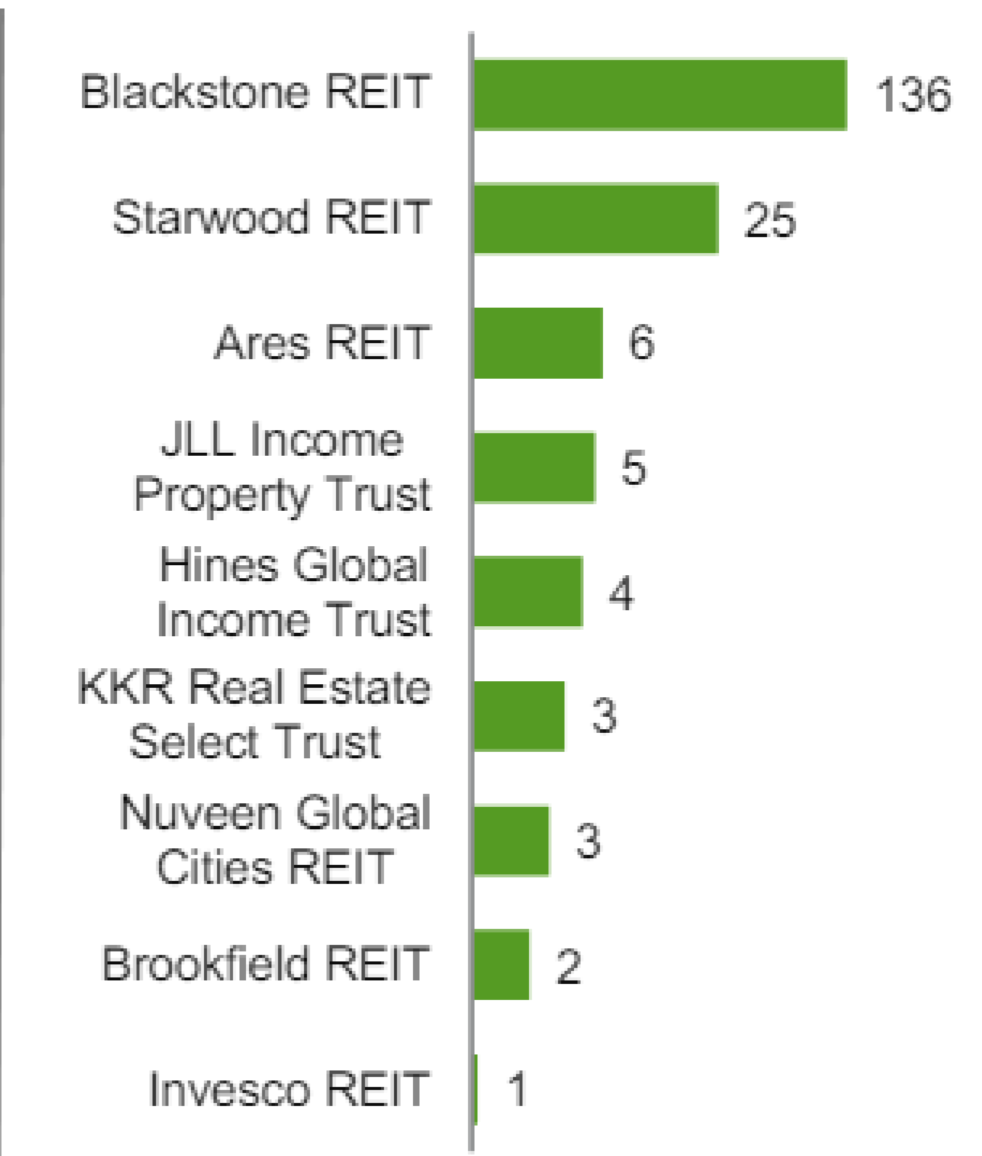
Net Capital Flows into Non-Traded REITs Show Signs of Bottoming

New commitments have declined as redemptions have gained momentum, creating negative pressure on net flows. Cash flows will remain negative for as long as appraised values remain at a premium to market values. The current situation essentially offers redeeming shareholders an arbitrage. That said, there is significant heterogeneity across individual fund vehicles vis-à-vis redemption queues and the ability to meet them. In general, redemption queues appear to have shrunk in recent months, pointing to a potential inflection point, though a return to 2021-to-2022 inflows seems unlikely for now.

Non-Traded REIT Net Flows ($B)



Non-Traded REIT Asset Value ($B)

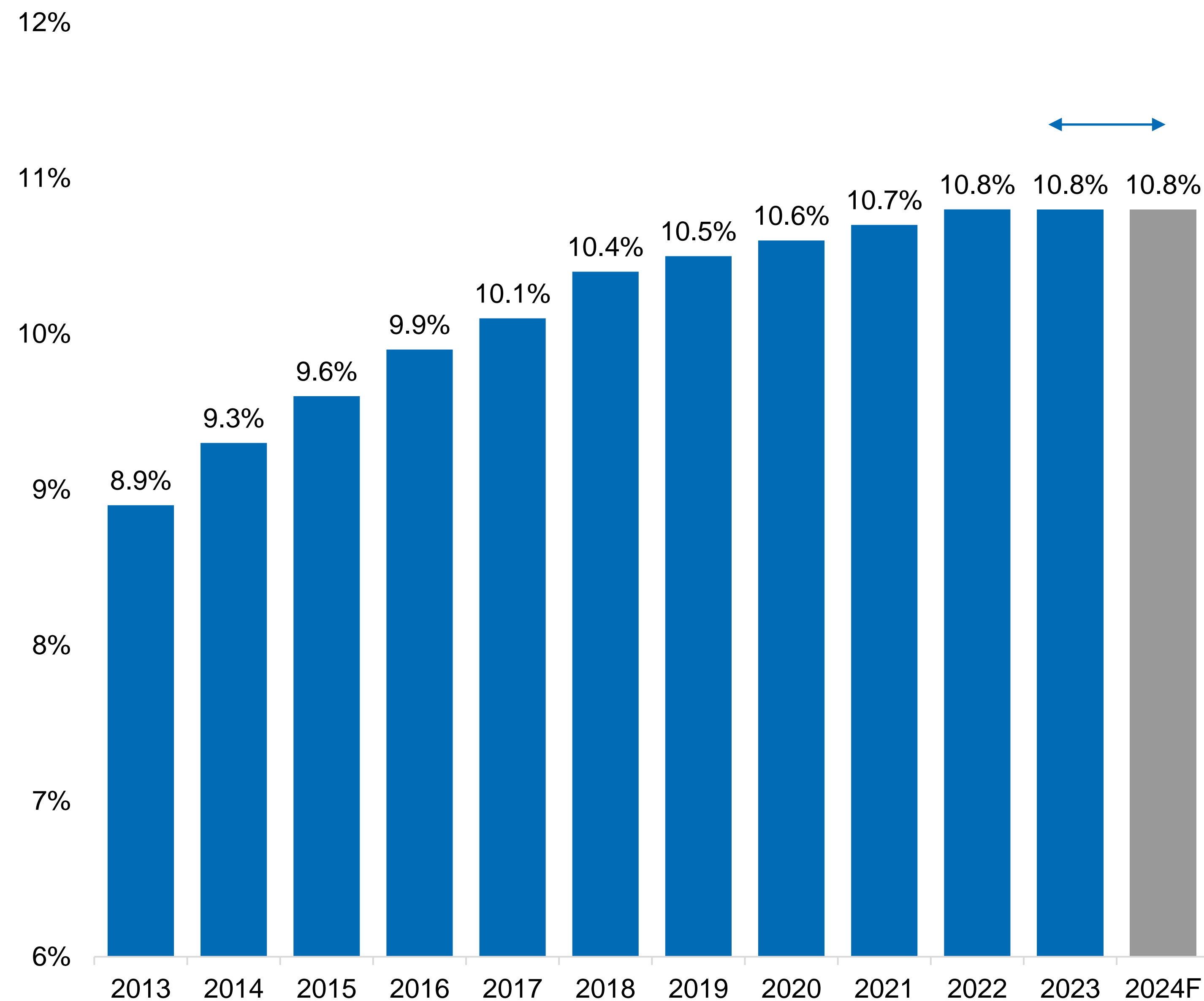


Sources: Newmark Research, Green Street FlowTracker Report as of 3/14/2024

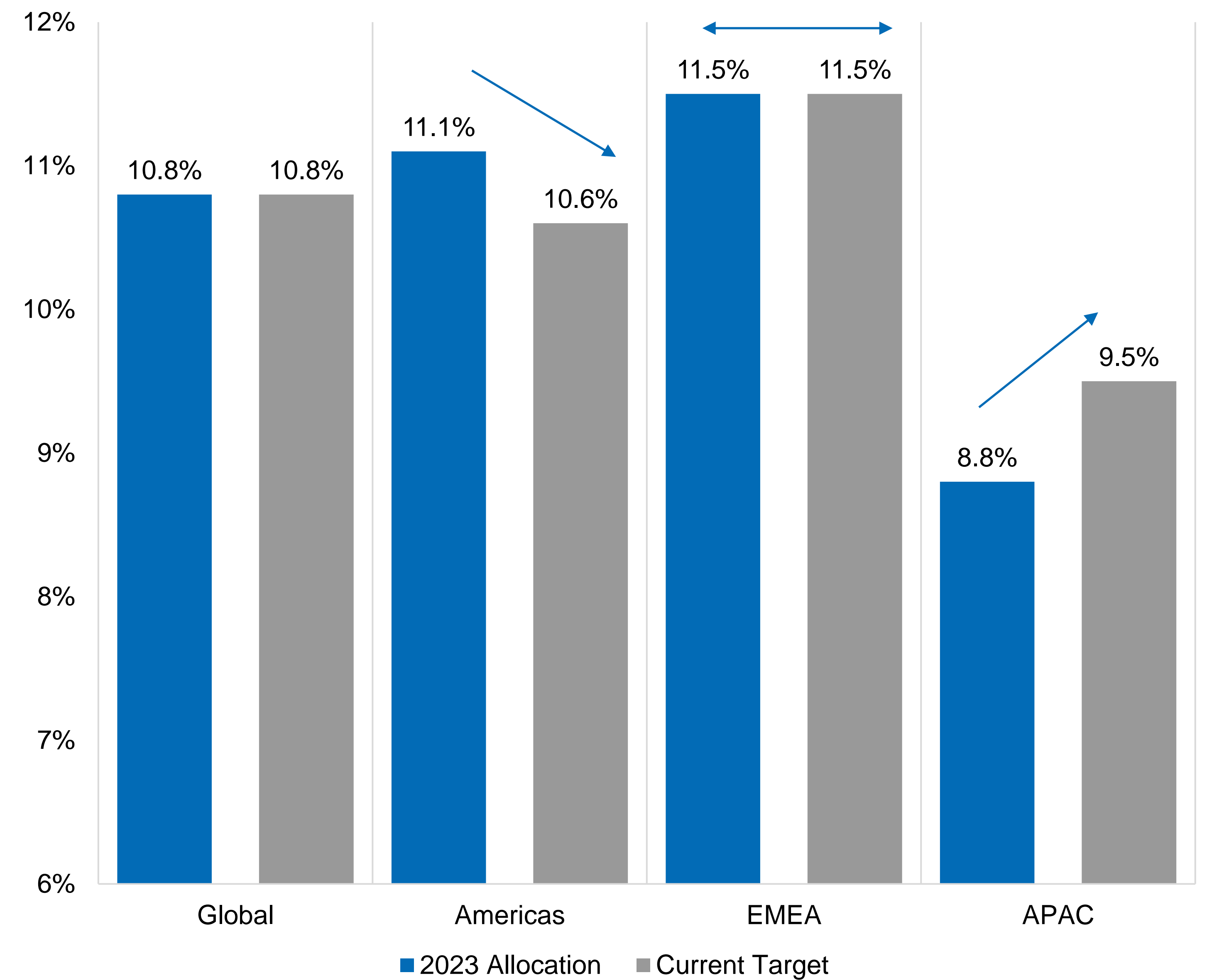
Institutional Allocations Approaching Stabilization after a Decade of Increase

When Hodes-Weill, a consultancy, surveyed 175 global institutions with $10.2 trillion in AUM, they found that: 1) globally institutions aim to hold their real estate allocations steady and that they have closed a heretofore persistent gap between actual and target allocations; 2) there is regional nuance with institutions in the Americas now above their targets and APAC institutions still below. Overall, this represents a deterioration in the outlook and curtails the prospect for a significant rotation of capital into the sector.

Target Allocation to Real Estate, All Institutions



2023 Actual vs. Target Allocation by Region of Institution



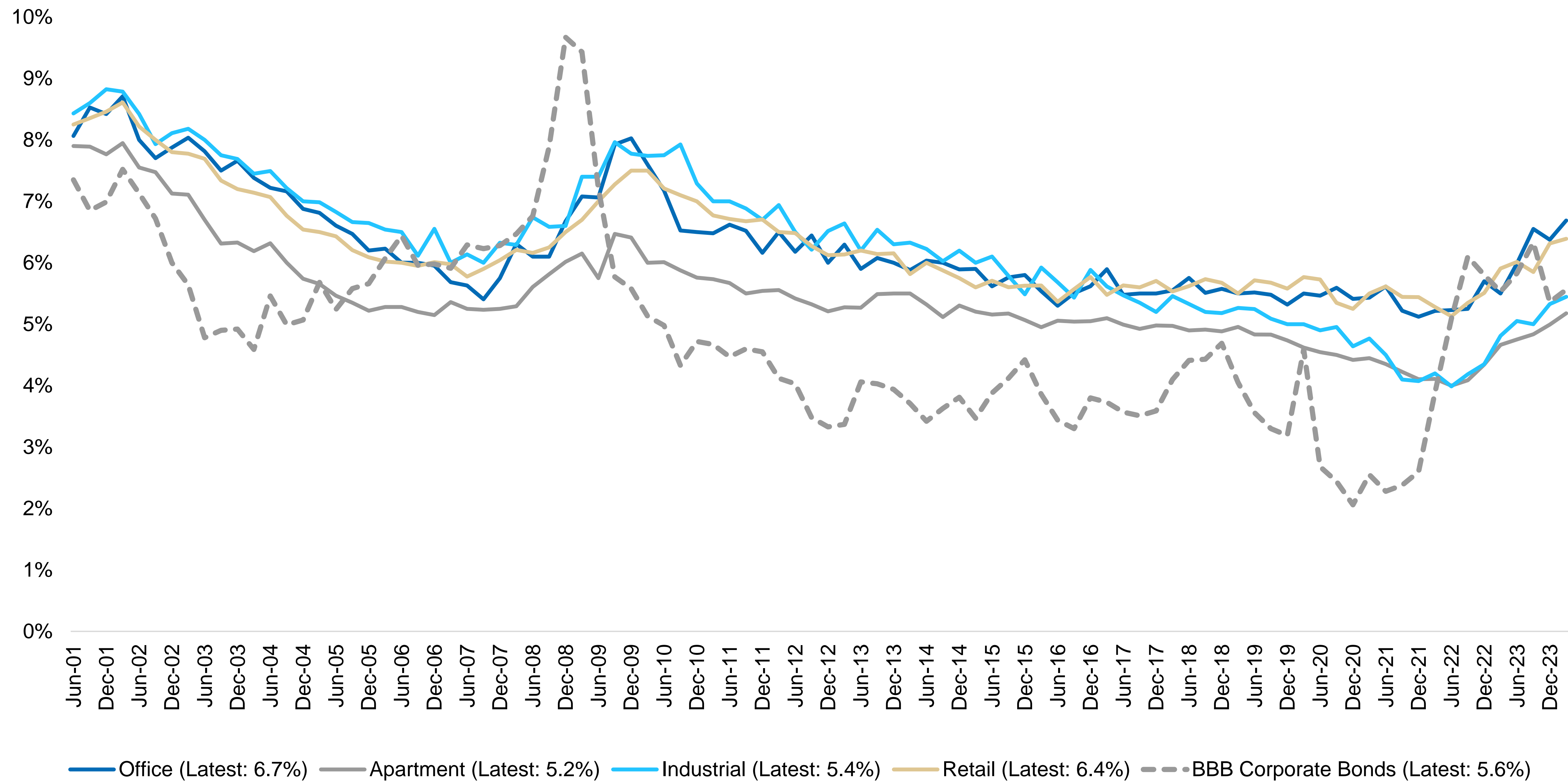
Source: Hodes-Weill Institutional Real Estate Allocations Monitor November 2023, Newmark Research

Pricing and Returns

Transaction Cap Rates Continued Their Upward Trend in 1Q24

Cap rates face upward pressure from rising debt costs and higher yields on alternatives to CRE investments – proxied here by BBB corporate bonds. Long-term Treasury yields fell in the fourth quarter of 2023 and corporate bond spreads compressed, amplifying the effect. This removed some but by no means all the upward pressure on cap rates. More recently, Treasury yields have been trending upwards, but this has been mitigated by corporate credit spread compression to near-record lows. Spread normalization is a major risk.

Top Quartile Transaction Cap Rate*



Source: Real Capital Analytics, Federal Reserve Bank of St. Louis, Moody's as of 5/3/2024
*Quarterly

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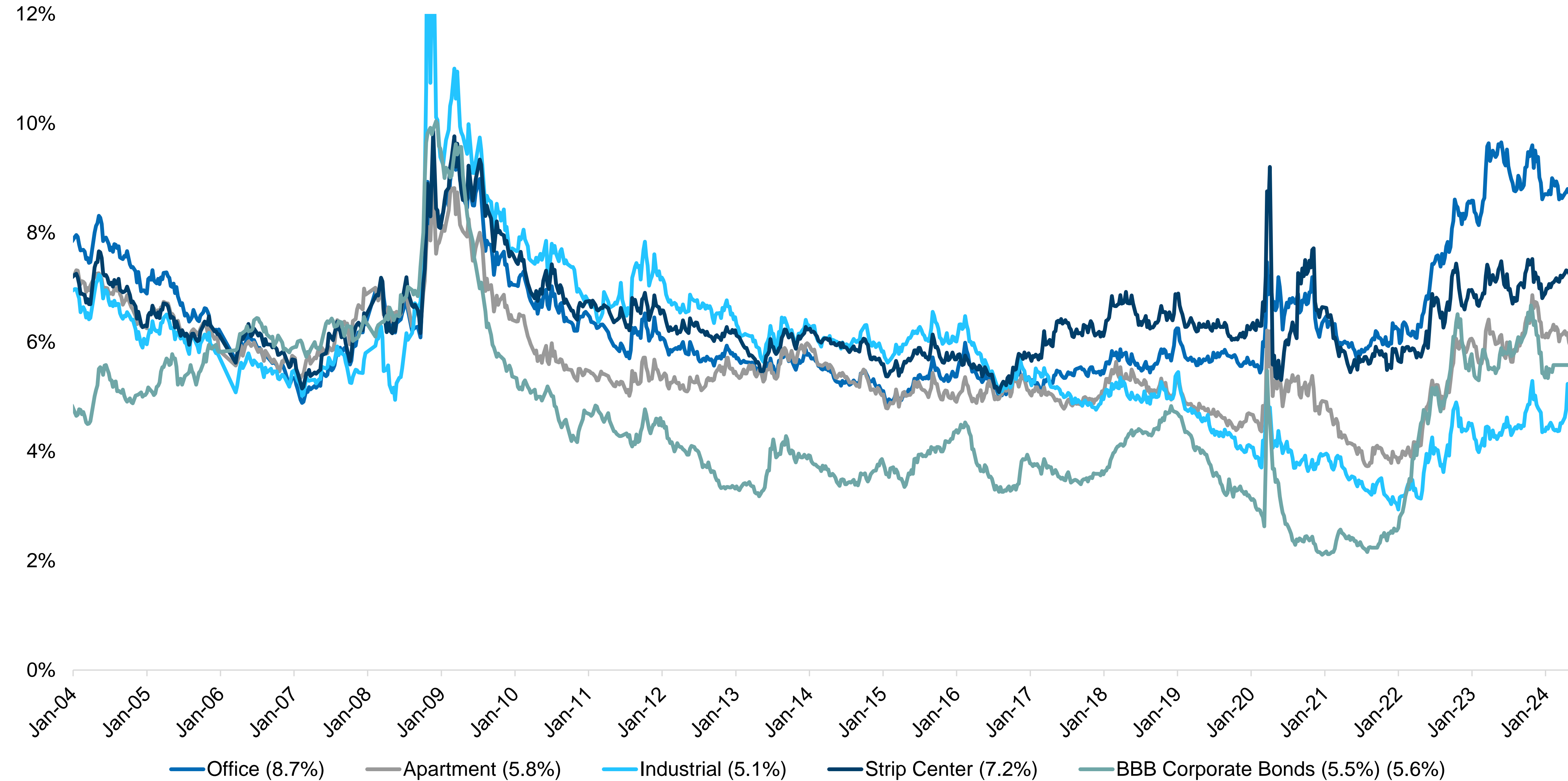
Public Markets Highly Sensitive to Rates; Continue to Underprice Risk

Office spread is 85th percentile relative to history*, apartment 18th, industrial 11th and strip center 41st. Spreads have risen broadly as BBB bond rates have come down. The question investors need to ask themselves is, "Is this asset class really less risky than it has been except for X percent of the time?" That's what accepting these spreads signifies.

REIT Implied Nominal Cap Rate



Source: Green Street, FRED, Moody's, Newmark Research as of 5/15/2024
*Using normal distribution

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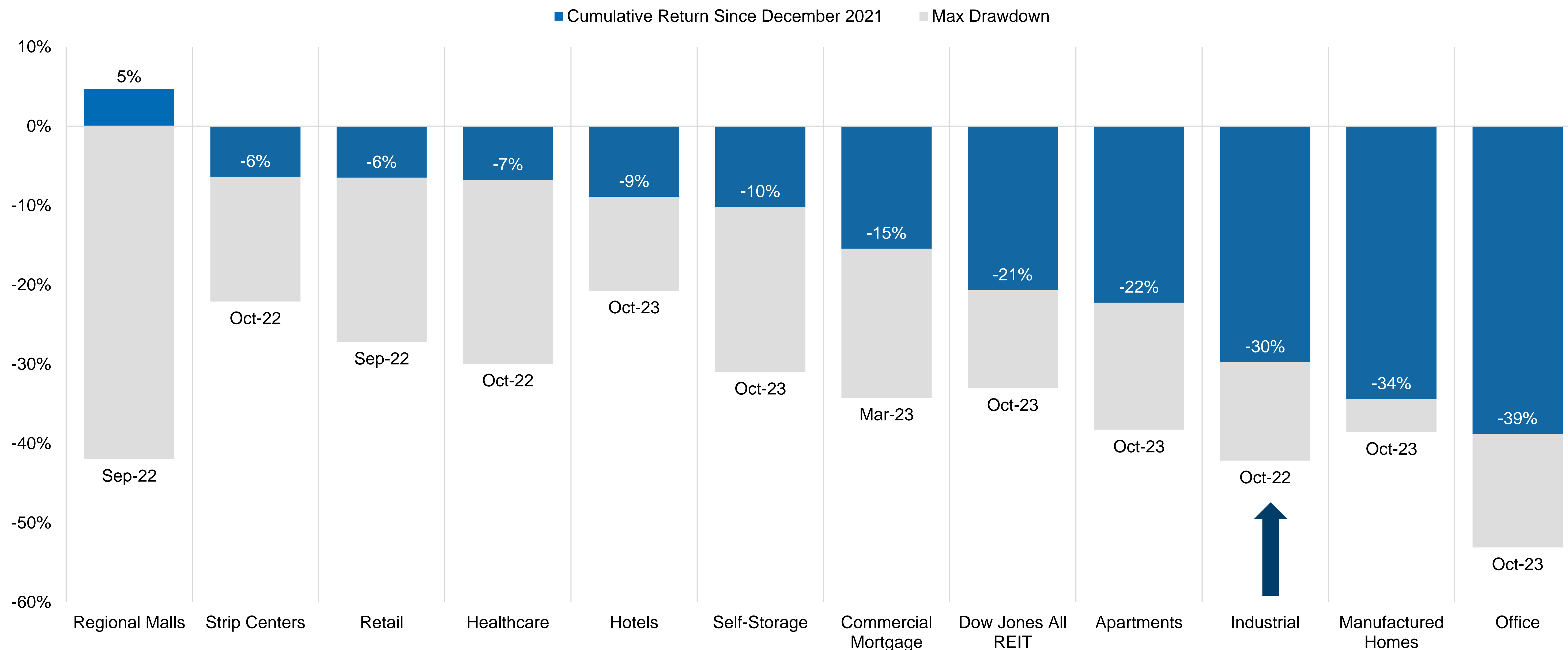
REITs Have Generated Negative Total Returns Since the Hiking Cycle Began

All REIT sectors except for regional m alls have recorded negative total returns since December 2021 or roughly when the current monetary policy cycle began. There has been significant heterogeneity across REIT sectors and cyclicality within the overall downward trend. To illustrate, the Dow Jones All REIT index is up 18.4% since its October 2023 lows. Office, industrial and multifamily have experienced the greatest drawdowns while retail, healthcare and hotels have been comparatively resilient.

Dow Jones REIT Index Total Returns



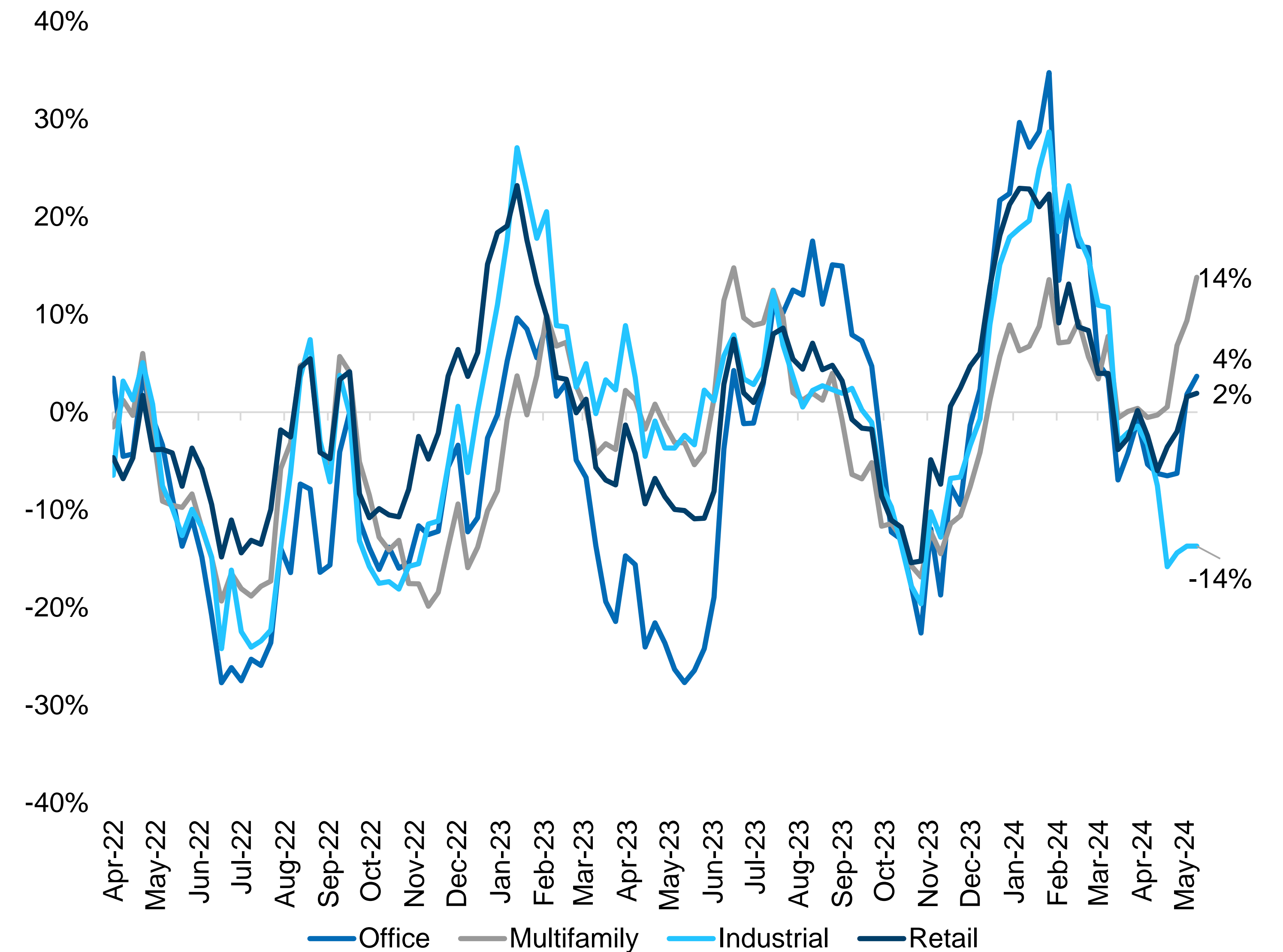
Source: Dow Jones, Moody's, Newmark Research as of 5/13/2024

REIT Returns Have Been Volatile with Periods of Significant Appreciation

As the prospects for declining interest rates have waxed and waned so have REIT returns. Taking a look at cumulative changes (left panel), while volatility is visible, the overall downward impulse from higher rates and, to a lesser extent, softening fundamentals leaves the dominant impression. The rolling 13-week return reveals just how many mini-cycles to which the market has been subject. This underlines the challenge of using public comparable to inform private property valuations on a tactical basis.

Dow Jones All Equity REIT Total Return Index

Dow Jones All Equity REIT Total Return Index: Rolling 13-Week Return



Source: Dow Jones, Moody's, Newmark Research as of 5/13/2024

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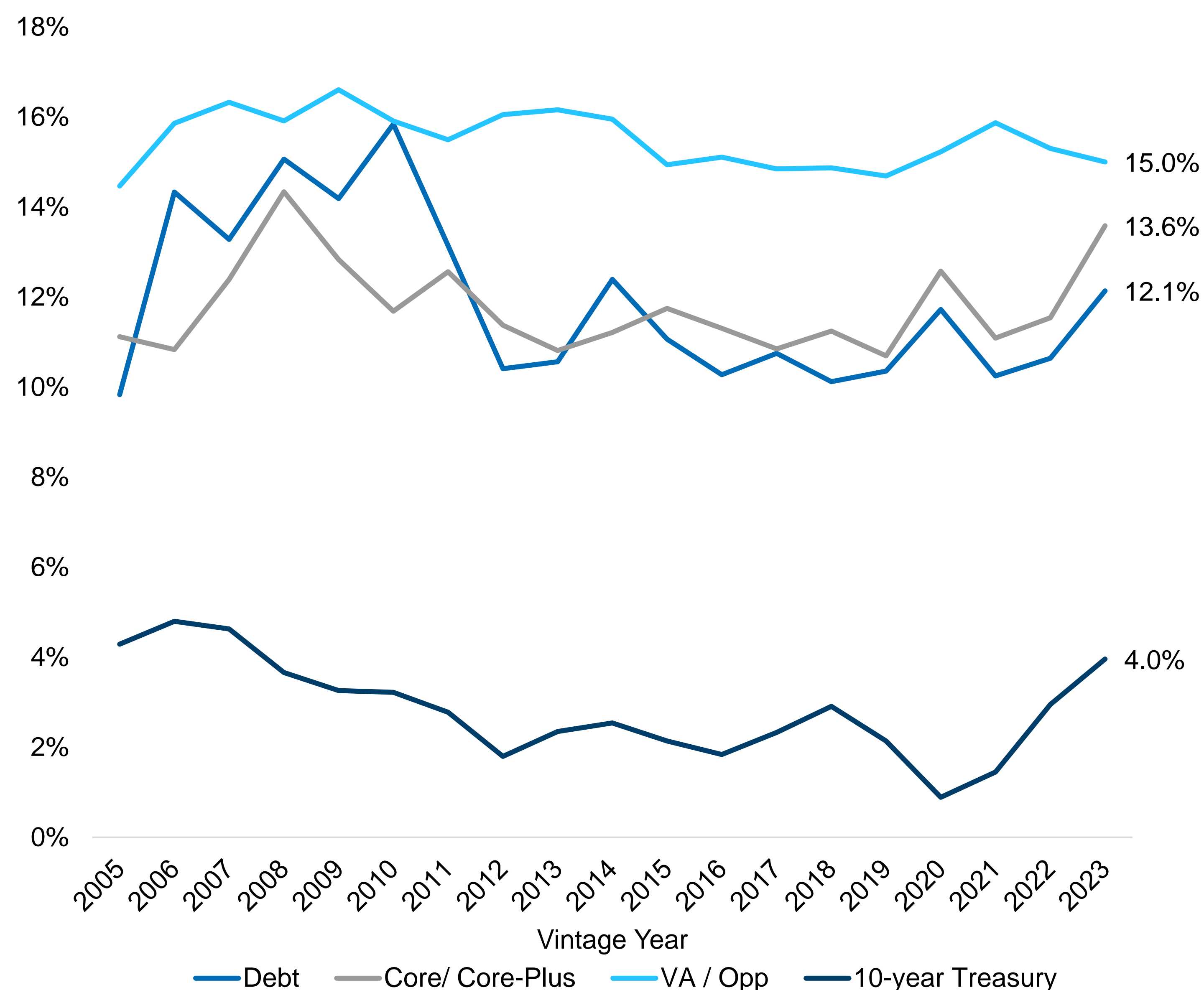
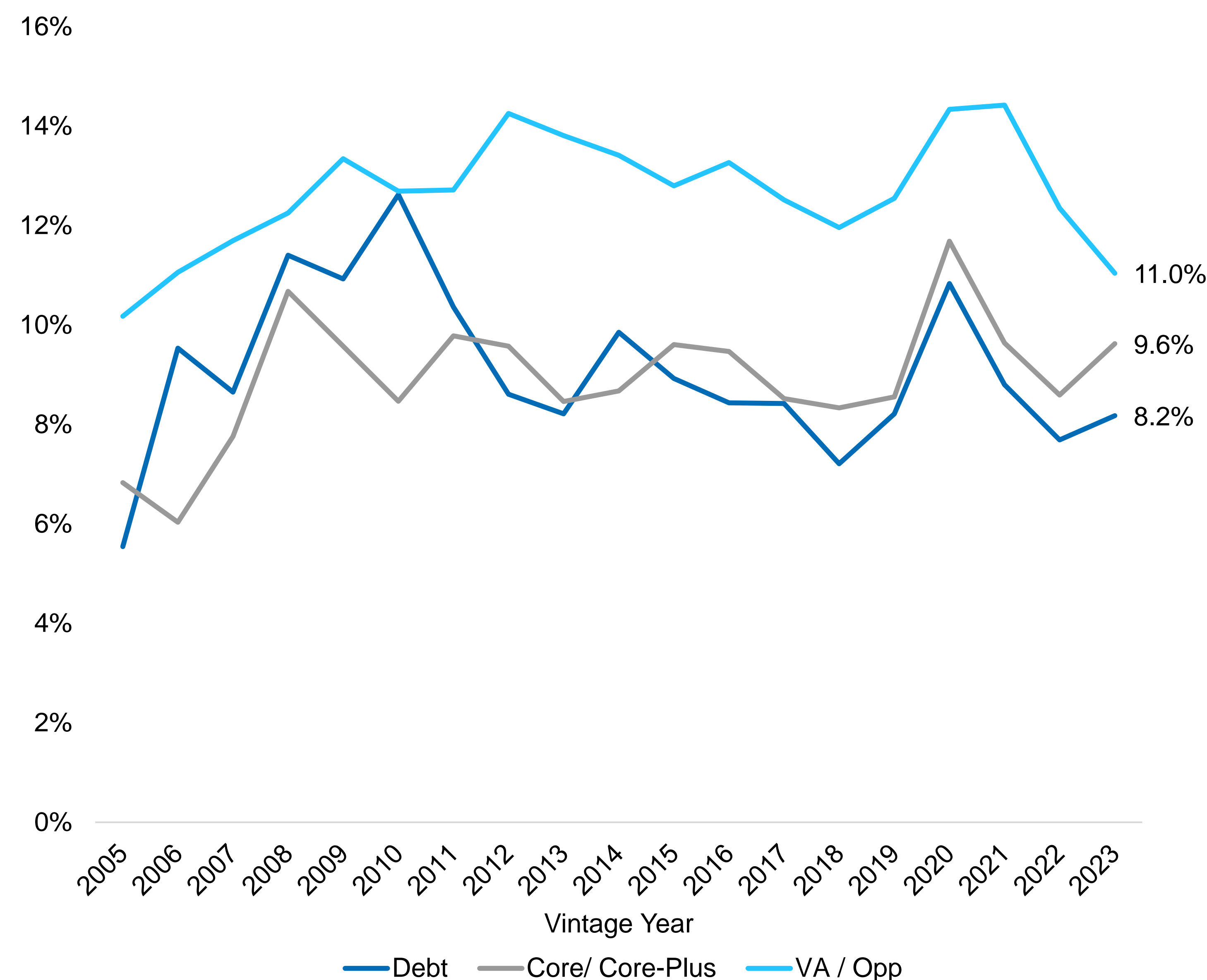
Private Equity Target Returns Surprisingly Insensitive to Changes in Rate Environment

Generally, investors should only be willing to invest in risky strategies to the extent that they expect higher returns compared to less risky investments. Accordingly, if the return to low-risk investments (e.g. Treasuries) rise, then required rates of return should rise for riskier strategies, such as real estate private equity. Since 2005, private-equity target IRRs have born little relation to changes in Treasury yields. In effect, this blunts the impact of rate volatility on valuations. This may have begun to change – at least for debt and core funds, which are now targeting returns within spitting distance of value-added and opportunity funds. This in turn could limit the latter's ability to raise capital.

Average Target Net IRR at Private Equity Real Estate Funds by Vintage Year



Average Target IRR less 10-Year Treasury Yield

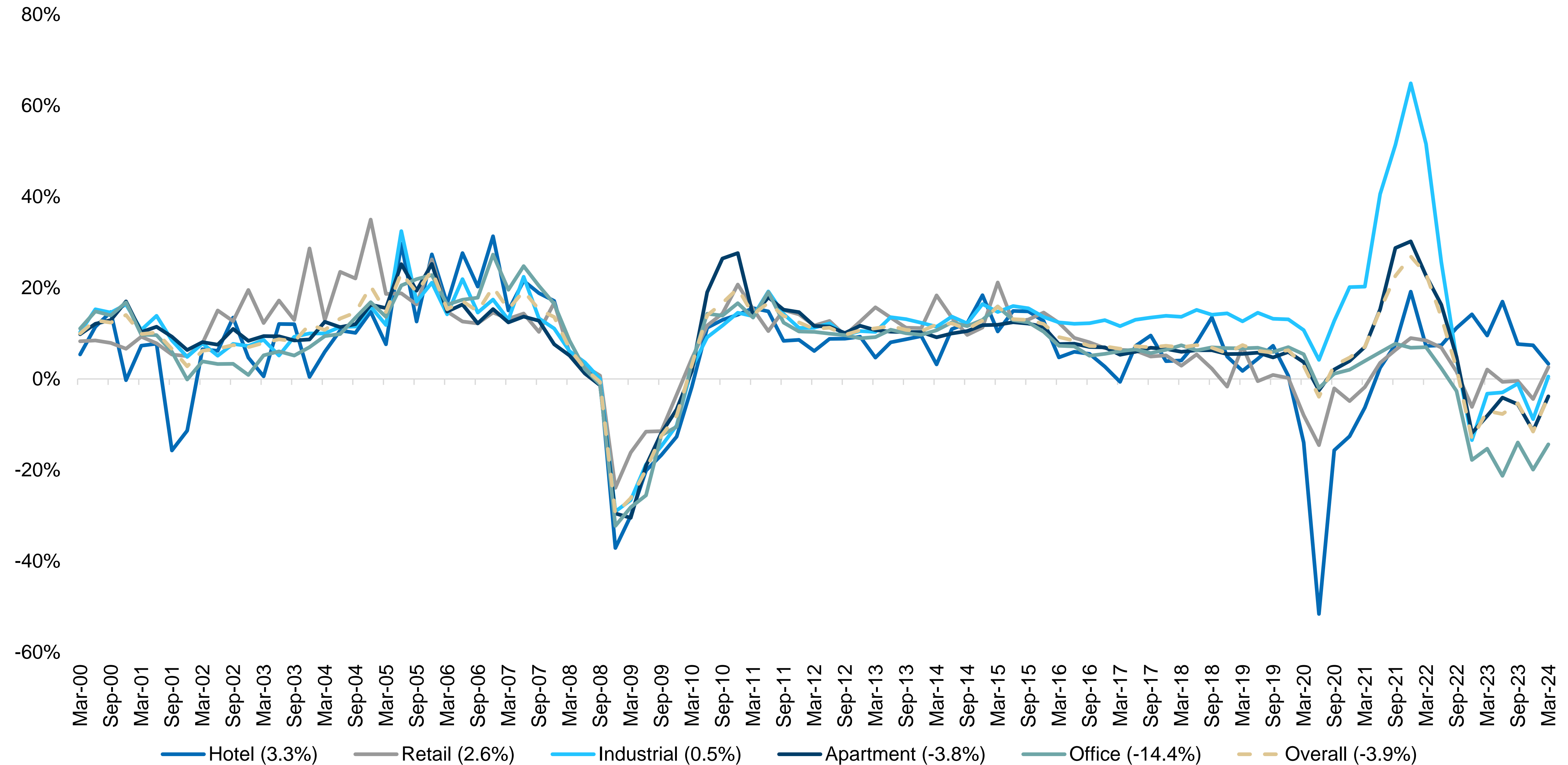


Source: Preqin, Federal Reserve, Newmark Research as of 4/26/2024

Private Market Core Property Returns Accelerated in 1Q24

Property returns improved broadly in 1Q24 according to NCREIF. For the overall index, total return accelerated from -11.5% annualized in 4Q23 to -3.9%. Industrial experienced the greatest acceleration from -8.8% annualized in 4Q23 to +0.5% in 1Q24, the first positive return for the sector since 3Q22. Retail returns also turned positive, increasing from -4.4% to +2.6% in the same period. Apartment returns, while still negative, improved on the margin. Office returns remain deeply negative but the pace of decline there too moderated.

NCREIF National Property Index Quarterly Annualized Total Return

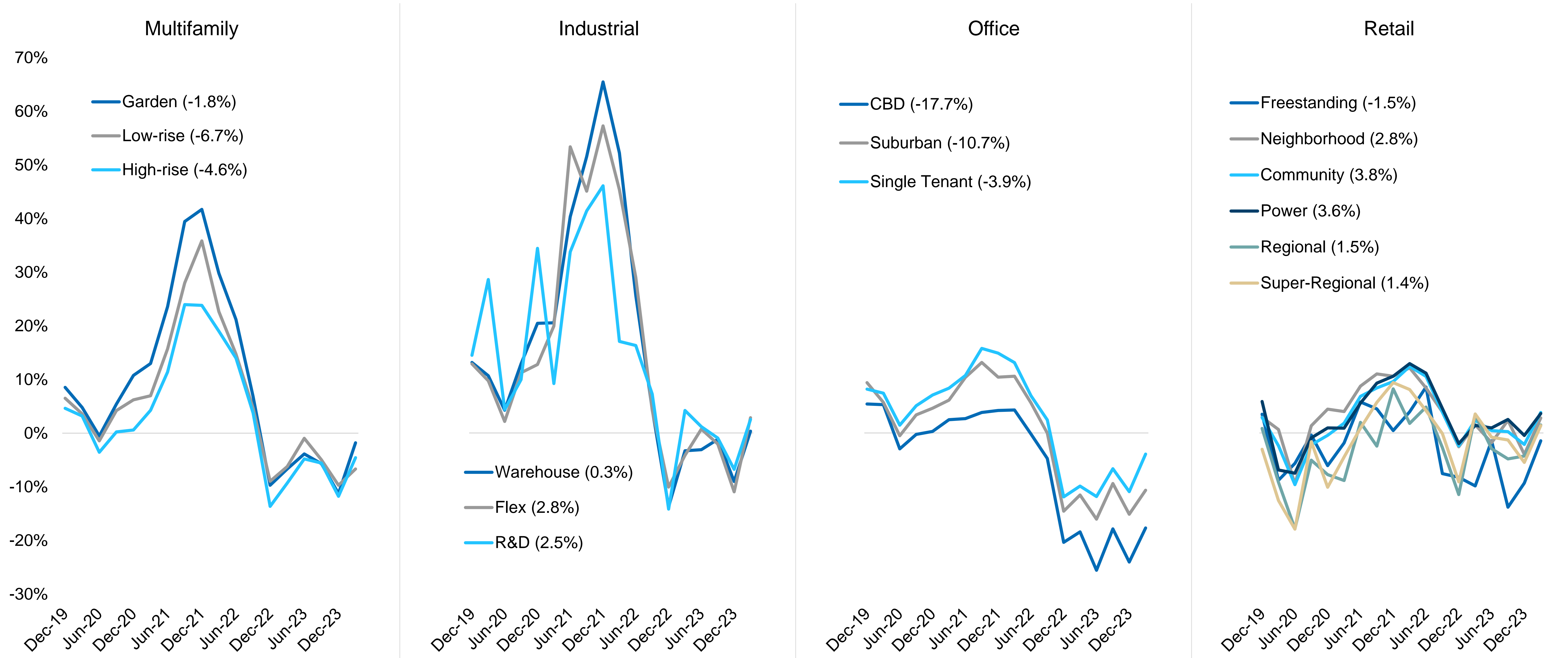


Source: NCREIF, Newmark Research as of 5/13/2024

Returns Improved Sequentially across Property Subtypes in 1Q24

Multifamily returns remain negative but improved on the margin with garden properties outperforming. Industrial returns rebounded strongly as all subtypes generated positive total returns. Office remains troubled, but here too returns accelerated. Single-tenant and suburban properties continued to outperform CBD assets. Retail returns were broadly positive with particularly strong performance among power center and community center assets.

NCREIF National Property Index Quarterly Total Return (Percent Annualized)



Source: NCREIF, Newmark Research as of 5/13/2024

Please reach out to your
Newmark business contact for this information

For more information:

David Bitner
Executive Managing Director
Global Head of Research
david.bitner@nmrk.com

Jonathan Mazur
Executive Managing Director
National Research
jonathan.mazur@nmrk.com

Mike Wolfson
Managing Director
Multifamily Capital Markets Research
mike.wolfson@nmrk.com

New York Headquarters
125 Park Ave.
New York, NY 10017
t 212-372-2000

nmrk.com

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