



Making sense of CRE in 2023

JLL Spark

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 **JLL** SEE A BRIGHTER WAY

“If I had to identify a theme at the outset of the new decade it would be increasing **uncertainty.”**

Kristalina Georgieva, Managing Director of the IMF

January 17, 2020

Uncertainty? Just as ChatGPT....

...Predicting the future of commercial real estate is inherently uncertain, but trends suggest a shift towards flexible work arrangements, increased focus on health and wellness in office spaces, and a continued rise in e-commerce driving demand for industrial and logistics properties, while the recovery from the COVID-19 pandemic and broader economic factors will play a significant role in shaping the industry's trajectory.

-ChatGPT

Economic and geopolitical trends creating uncertainty

War



China



Inflation



Interest rates



Trade



Supply chains



Energy



Secular shifts add to the complexity and opportunity

Future of Work



Sustainability (ESG)



Technology



Capital Flows

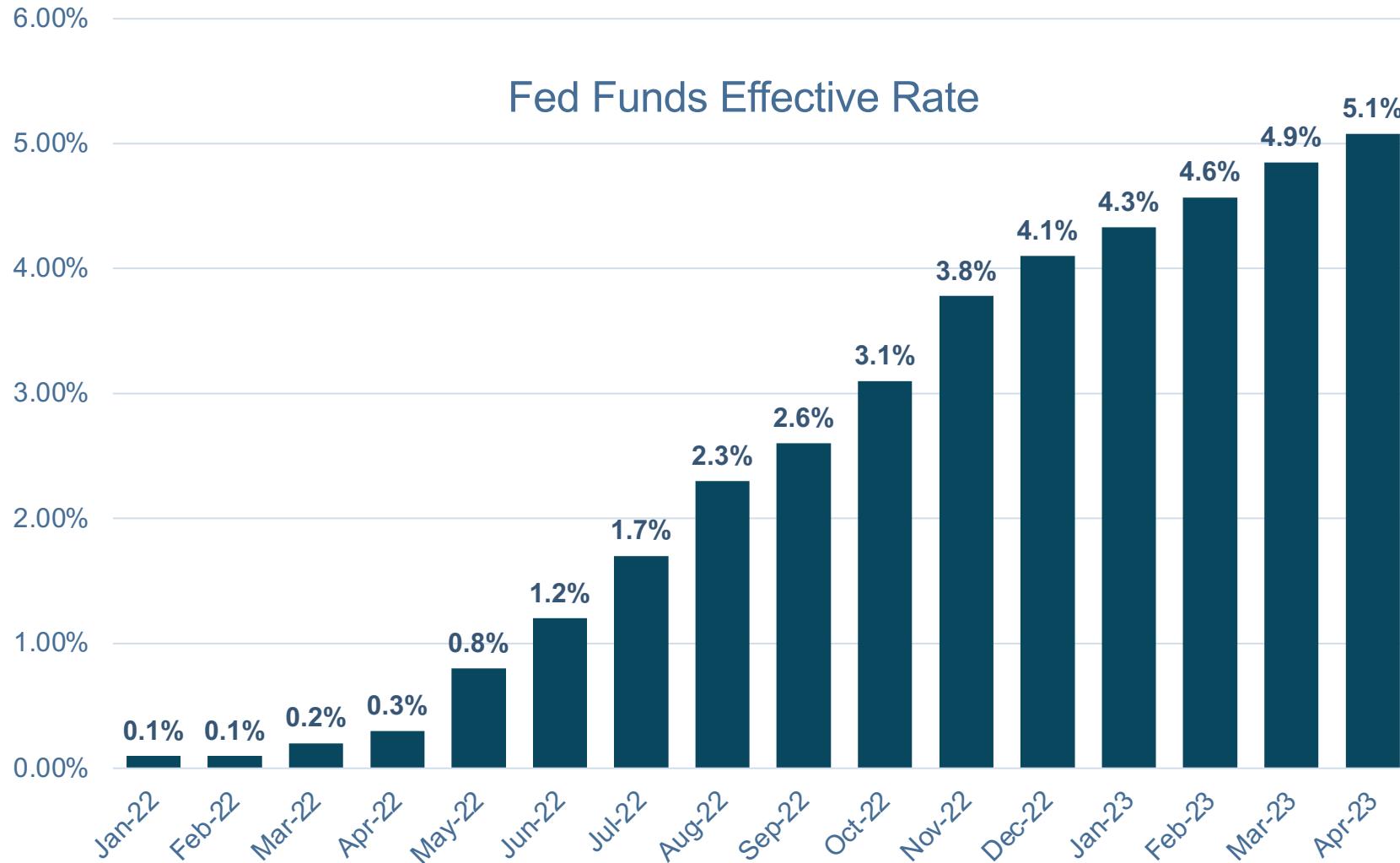


Urbanization

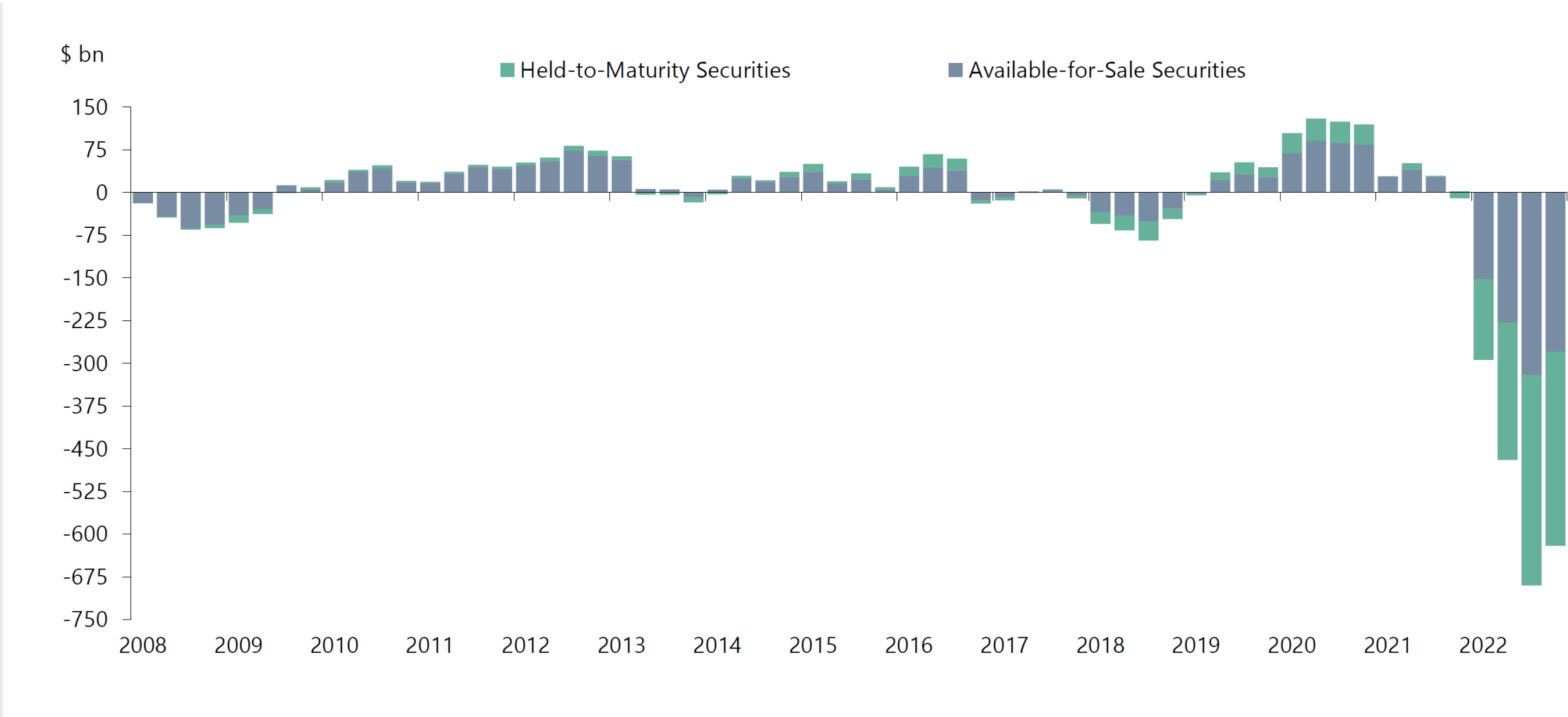


There is risk with “Jay-Walking”

“We have got to get inflation behind us. I wish there were a painless way to do that. There isn’t”. Jerome Powell, September 21, 2022



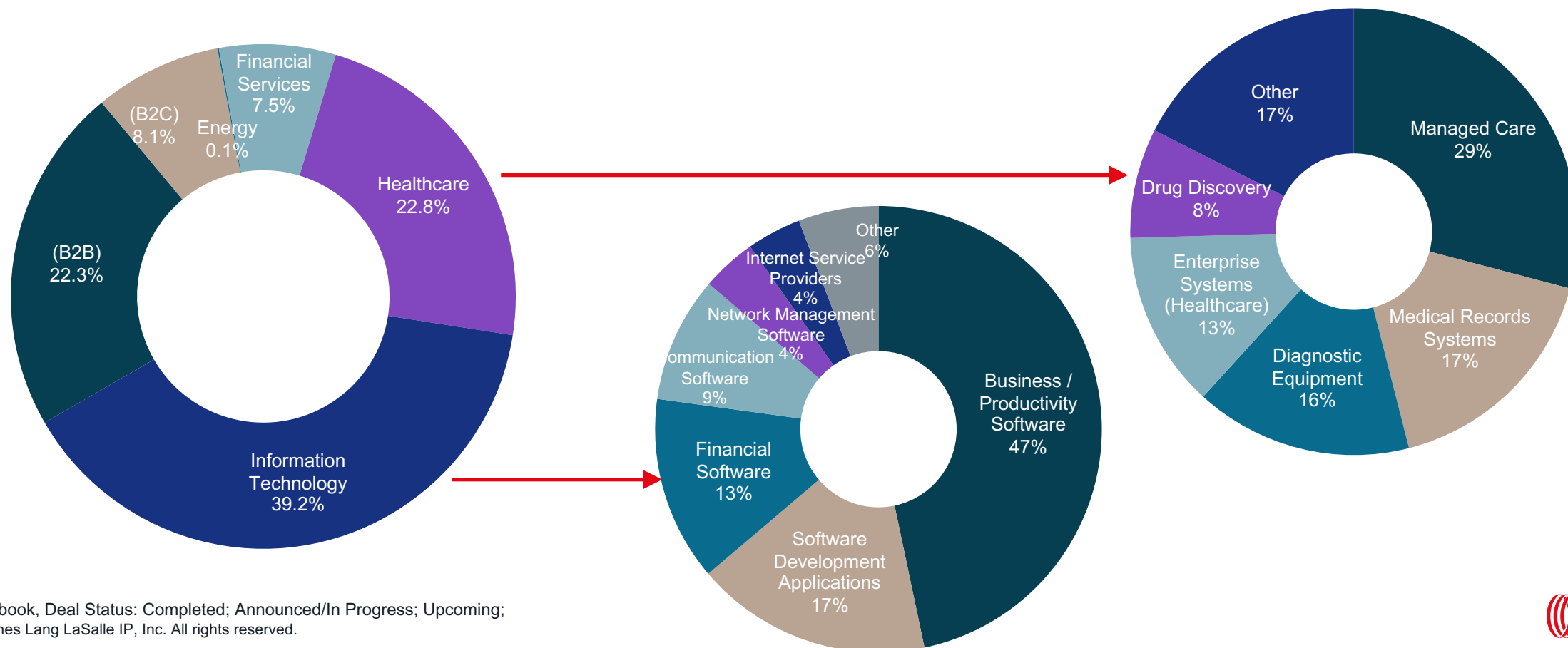
Unrealized gains / losses on investment securities for banks



svb  Silicon Valley
Bank

Impact on revolving lines of credit

- SVB focused on the startup community, offering more favorable rates than found elsewhere. When these companies renegotiate these loans, they may have to do so at higher rates that could change their financial position.
- The majority of companies with revolving lines of credit at SVB were in the information technology industry, followed closely by healthcare and B2B companies.

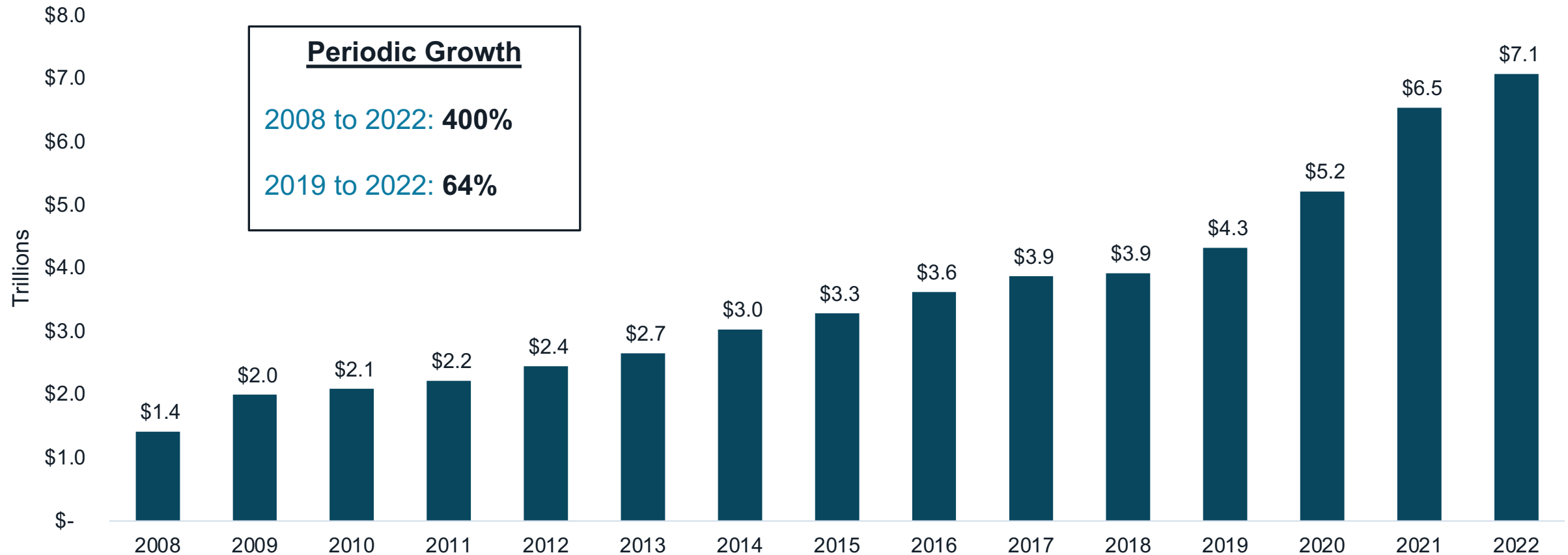


Who's next?



Local and regional banks accumulated significant deposits across the prior decade...

Total customer deposits at select large regional US banks

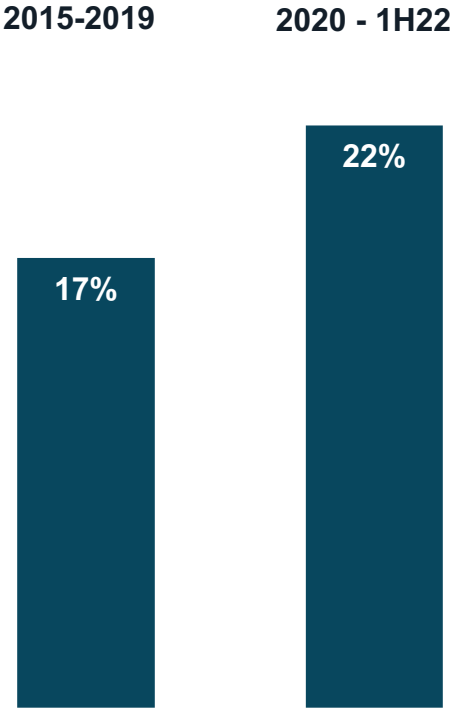


Source: JLL Research, Bloomberg Finance, L.P., company filings

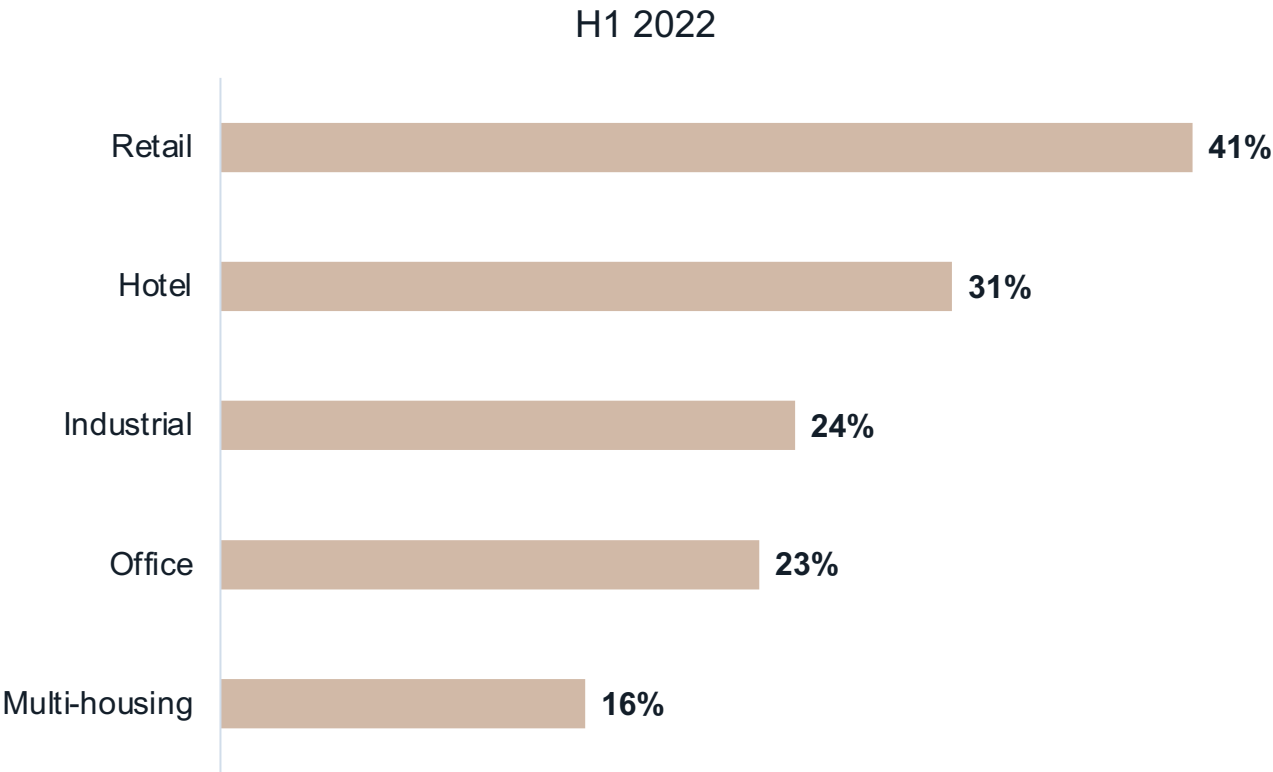
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...and have played an increasingly significant role in CRE lending markets in search of yield on deposits in a low-rate environment

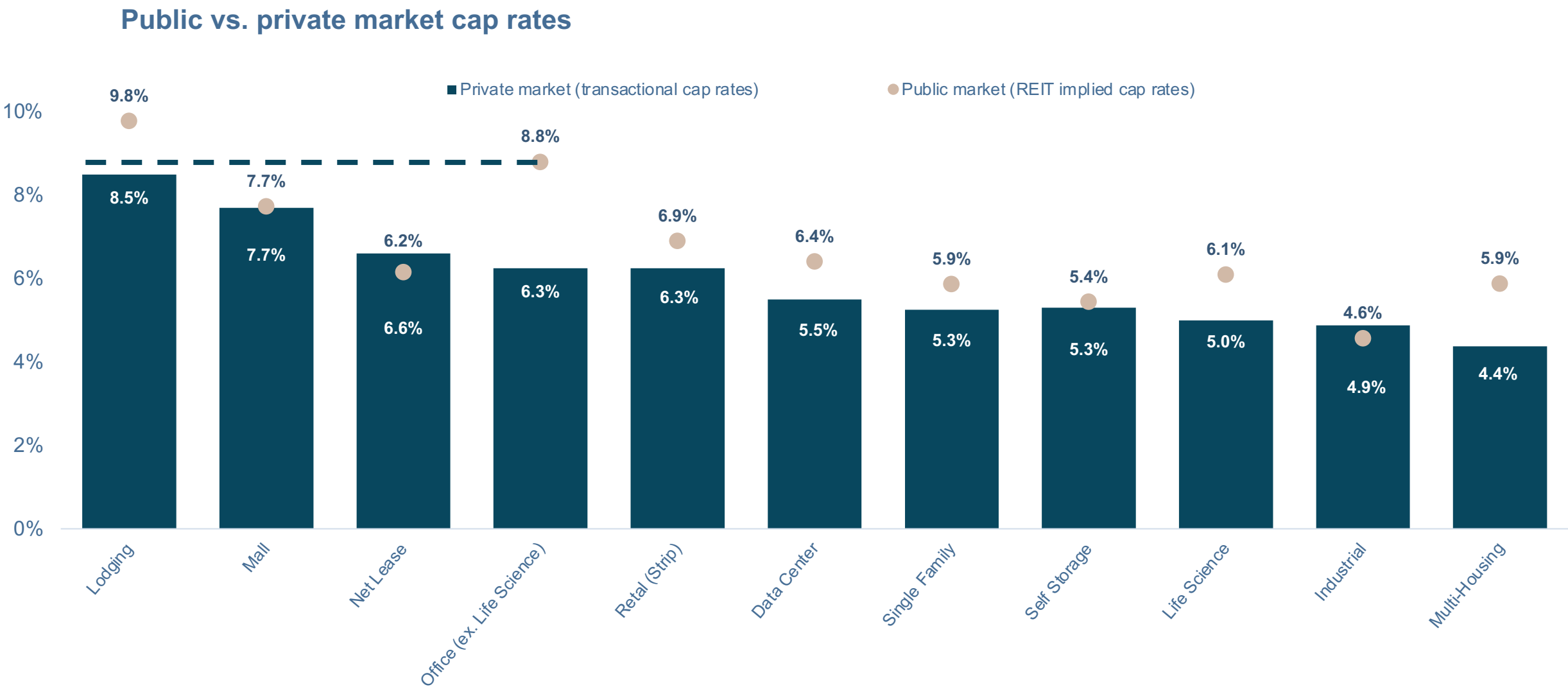
Share of CRE lending attributed to local and regional banks



Share of CRE lending attributed to local and regional banks by property sector



Public market pricing points to continued value compression



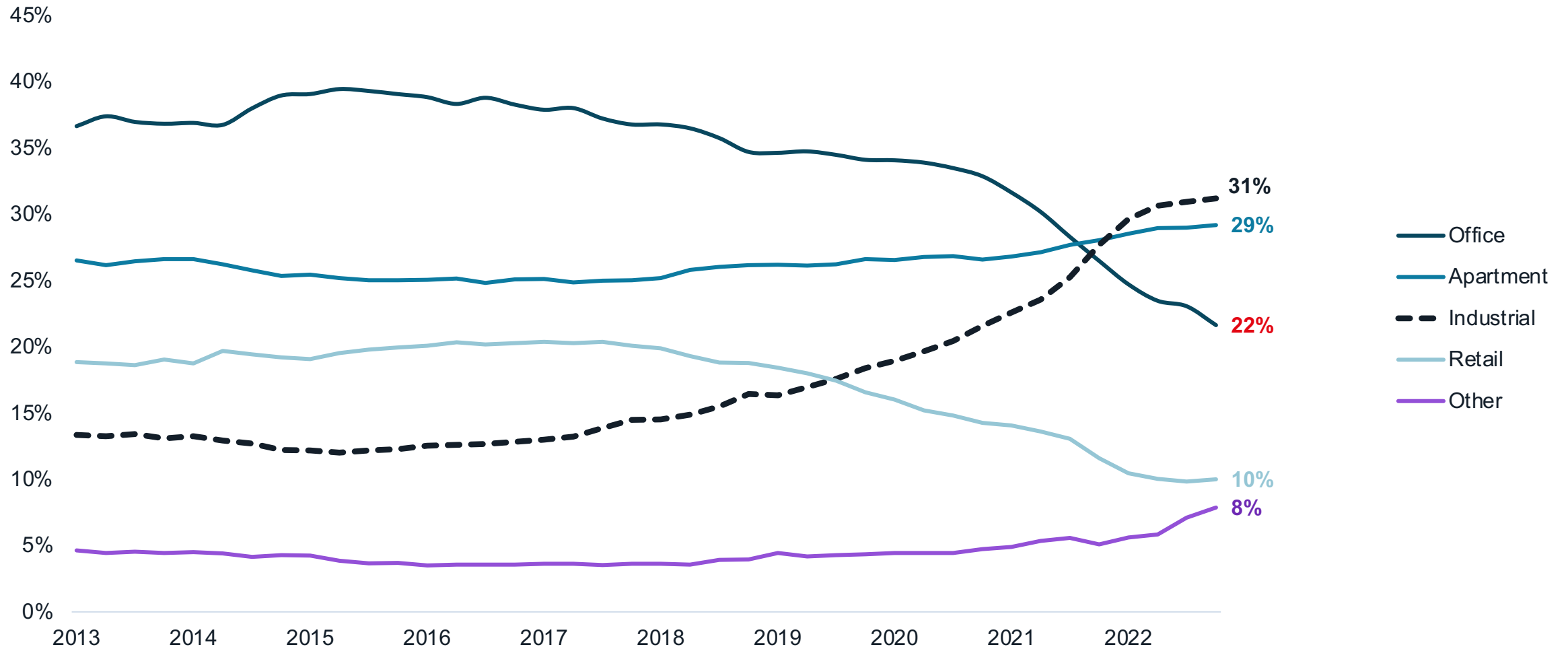
Source: JLL Research, Green Street

Source: JLL Research, Green Street, National Council of Real Estate Investment Fiduciaries, NAREIT



Rethinking the portfolio

ODCE index: property type composition

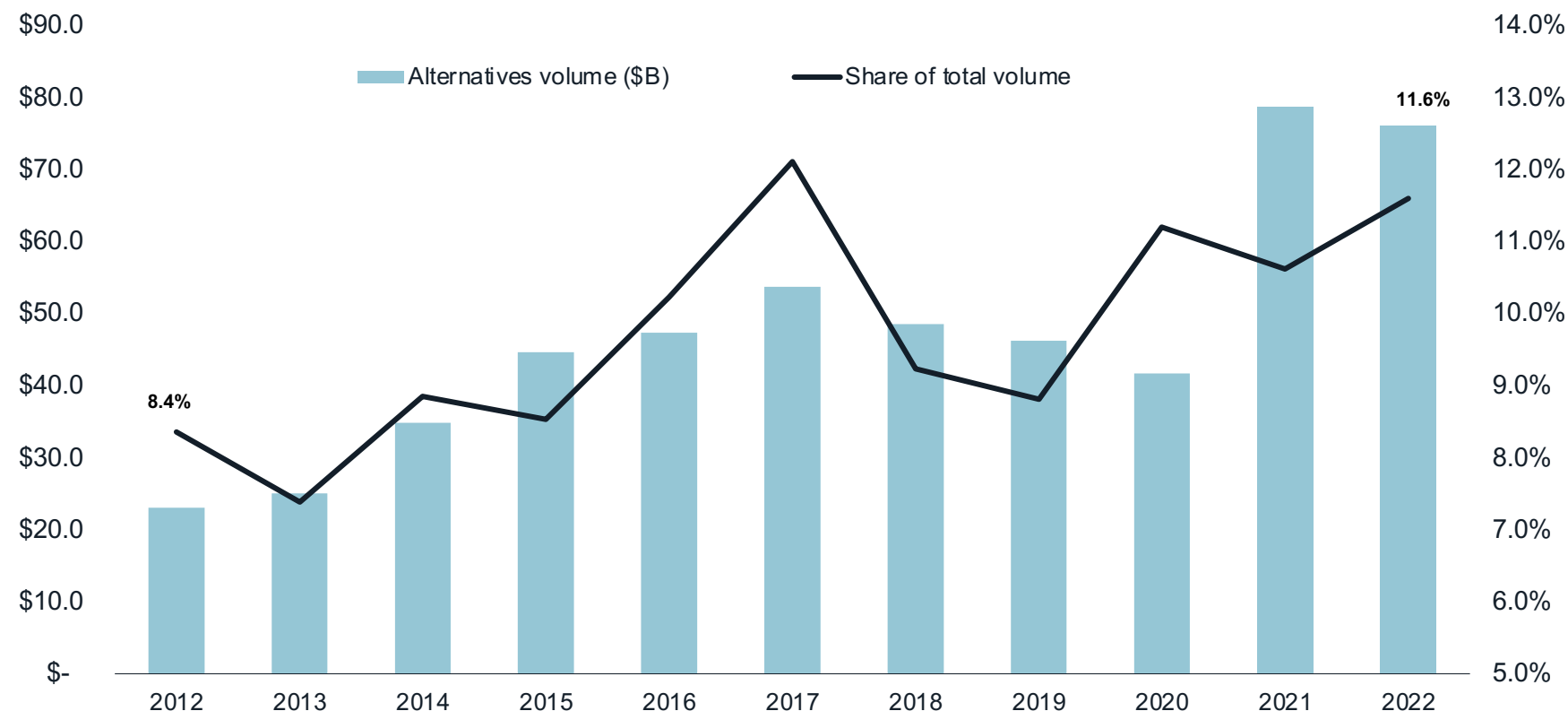


Alternatives come into focus as investors seek growth outside of traditional sectors

Alternative CRE Categories

- **Data centers**
- **Life sciences**
- **Manufactured housing**
- **Medical office**
- **Self-storage**
- **Single-family rentals**
- **Senior housing**
- **Student housing**

Alternative sectors capturing growing share of transaction volume over the prior cycle



Source: JLL Research, Real Capital Analytics

Real Estate conditions vary by sector



Office

Market bifurcation to continue with hybrid and recession risks weighing on volumes.

Outlook

Distress coming for commodity office markets with assets in need of capital to reposition or convert.



Retail

Inflation and recession dampen performance, but spending continues and retail investment grew in 2022.

Outlook

Grocery and Class A malls most resilient. Store optimisation and omni-channel capabilities will be key.



Hotels

Highly correlated to the economy, with leisure properties performing best and tourism increasing.

Outlook

Recession risk, but potential for activity with slowly recovering sentiment for urban assets.



Residential

Economic headwinds near term, rising rates to boost apartment demand and limit supply.

Outlook

Dynamics support rental growth/recovery. Living will remain the most liquid sector globally.



Logistics

Biggest price correction from rate hikes, but long-term structural drivers and scarce supply remain.

Outlook

Next 3-5 years likely to see significant shifts in supply chains from manufacturing to distribution.

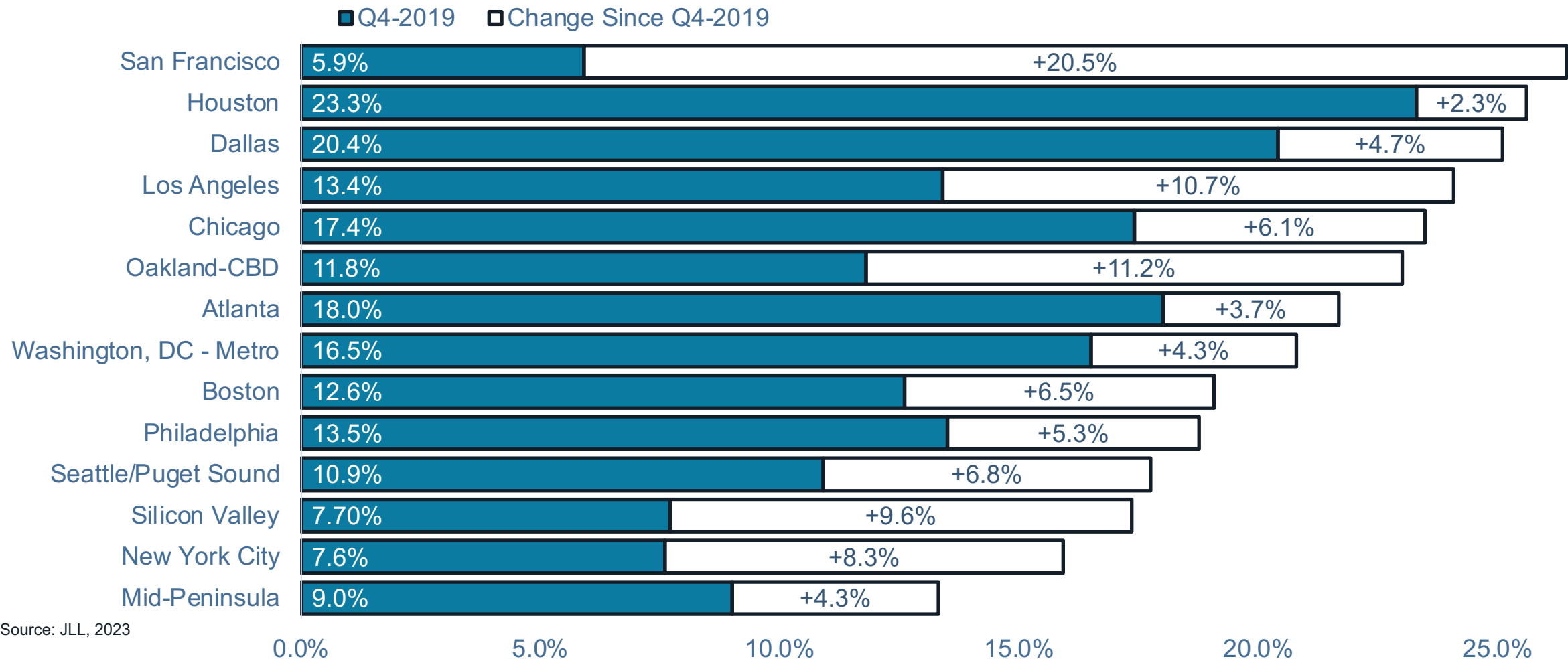




The Future of Work & Offices

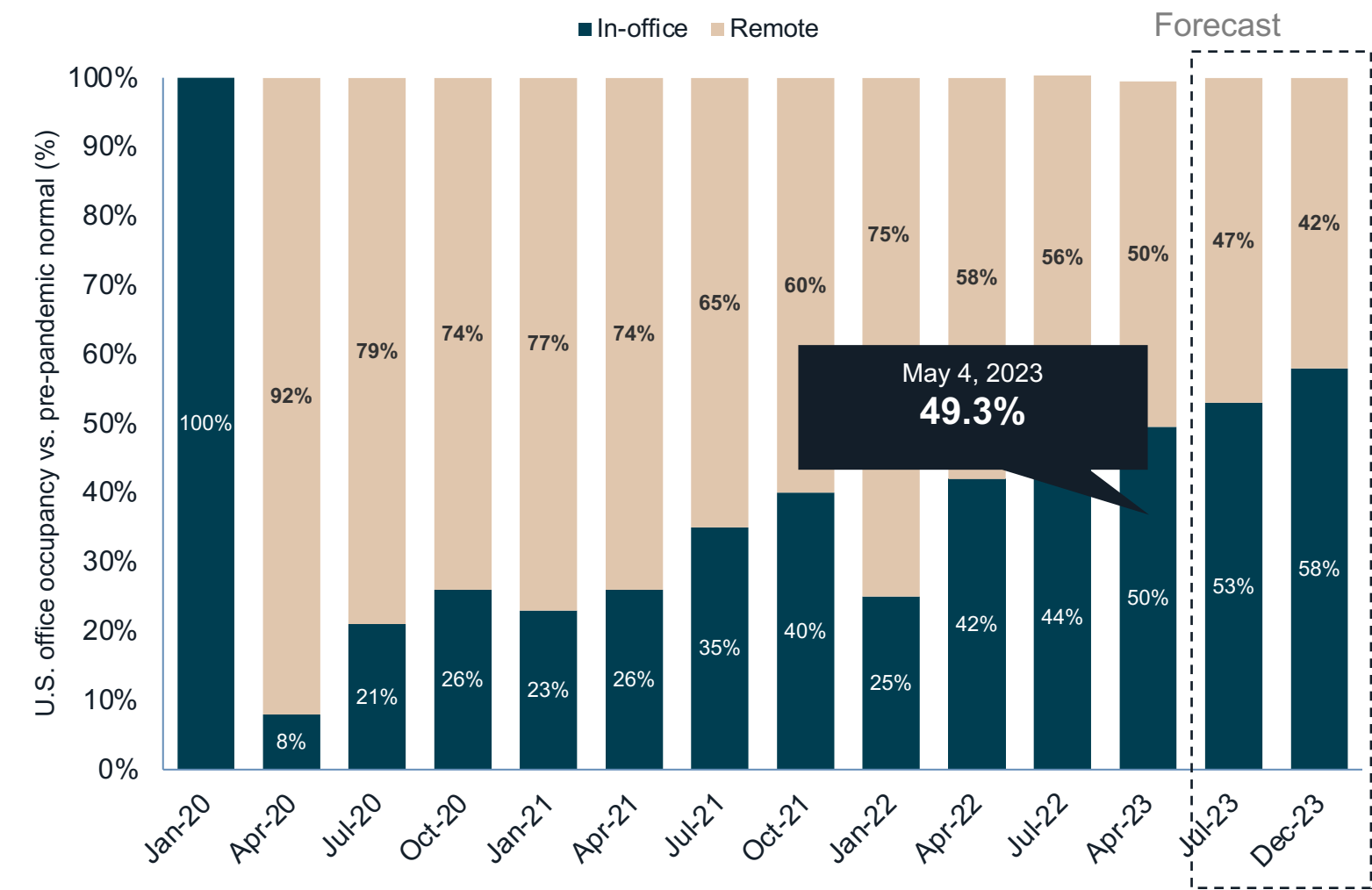
Office Vacancy

All office markets in the U.S. have realized an increase in vacancy since the pandemic with San Francisco seeing the highest increase in vacancy.



Source: JLL, 2023

Office re-entry dipped in December but have held relatively flat at 50% since the January 2023. September 2023 should see additional wave of return to the office.

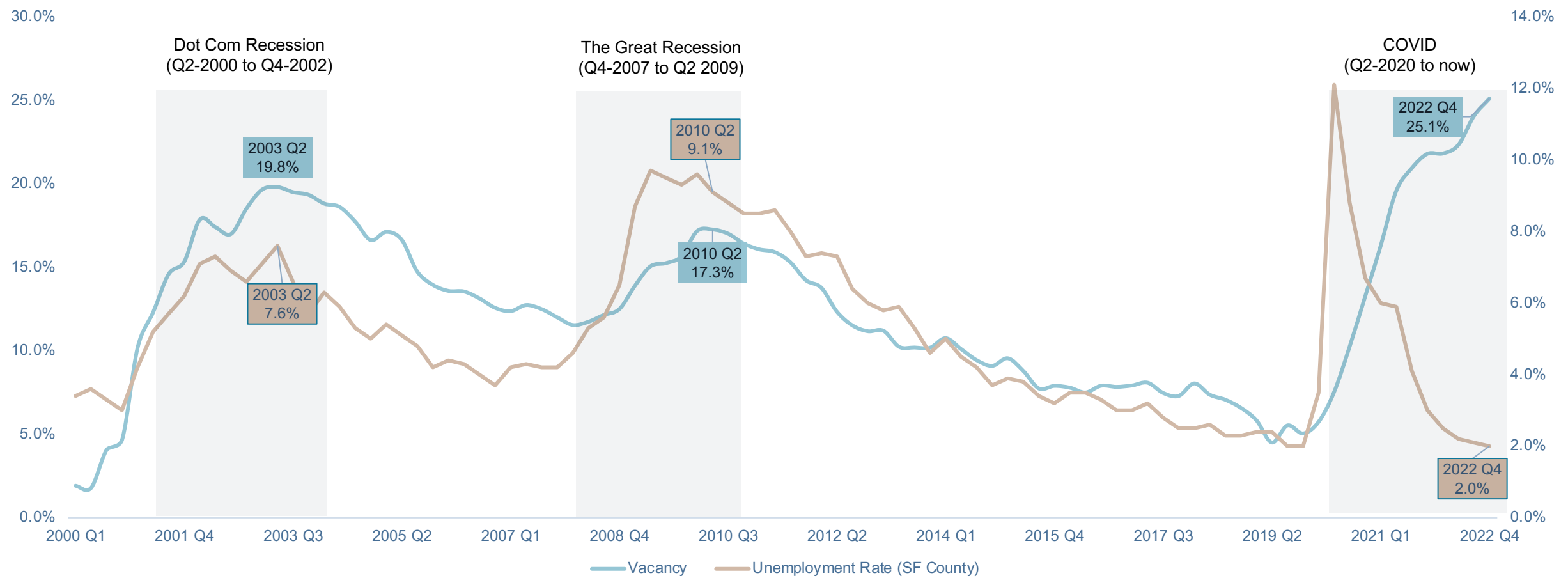


Market	Re-entry rate (%)
Austin	60.6%
Houston	60.0%
Dallas	53.4%
Chicago	50.7%
Los Angeles	49.0%
New York	48.9%
Washington, DC	46.3%
San Francisco	44.0%
Philadelphia	41.5%
Silicon Valley	38.2%

Includes non-desk-using employees, such as janitorial and mail room staff, who reported to the office throughout the pandemic. As 4/5/2023.

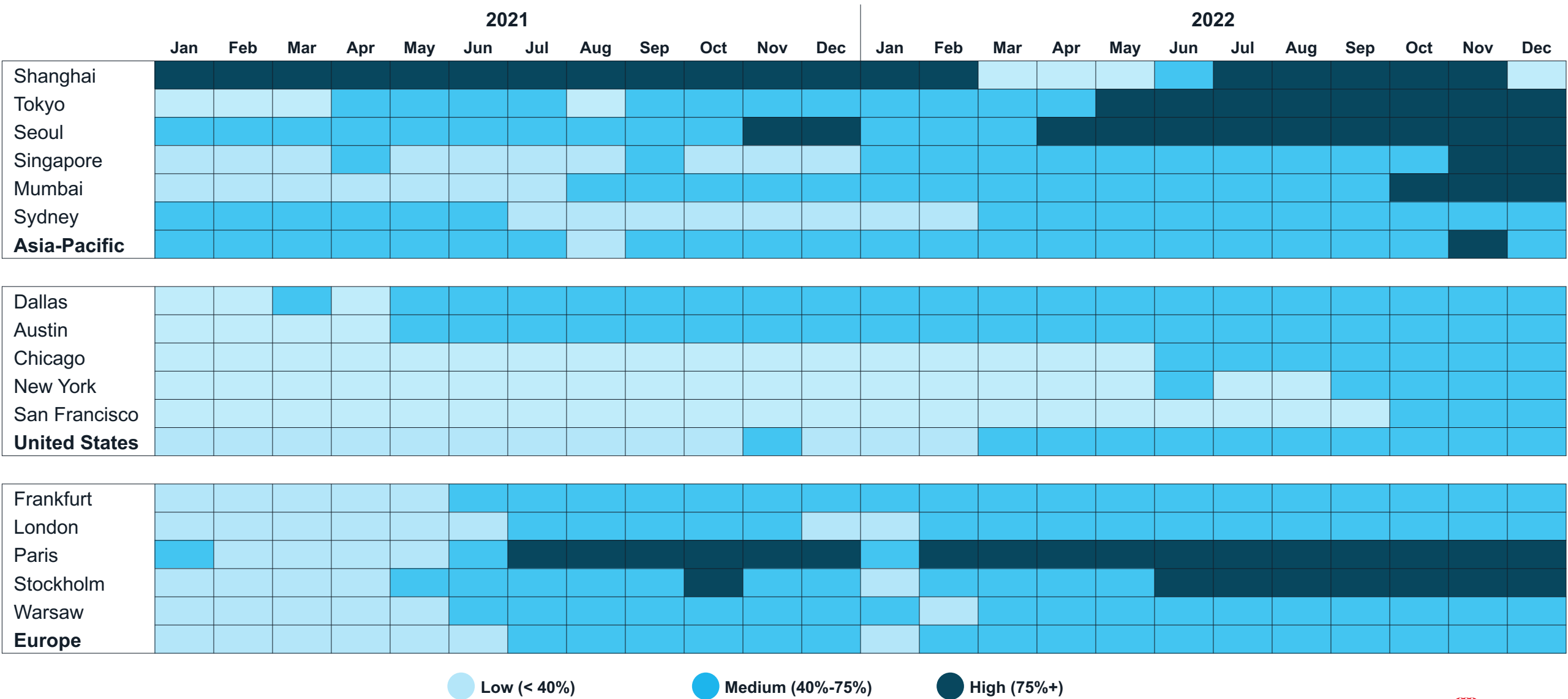
Office Vacancy and Unemployment Rates Decouple

Before covid, unemployment rates had a strong positive correlation with vacancy; however, the inverse has happened since Q2-2020.

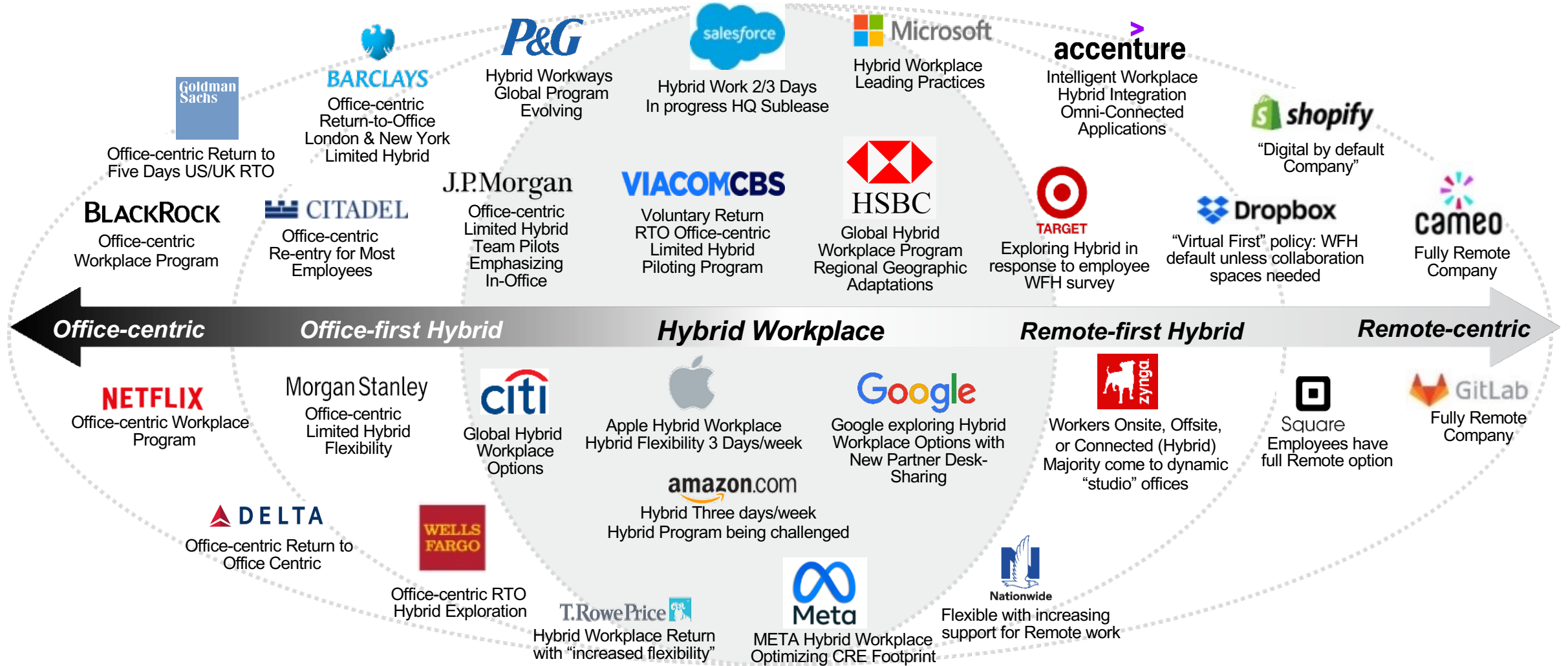


Source: JLL, 2023, EDD

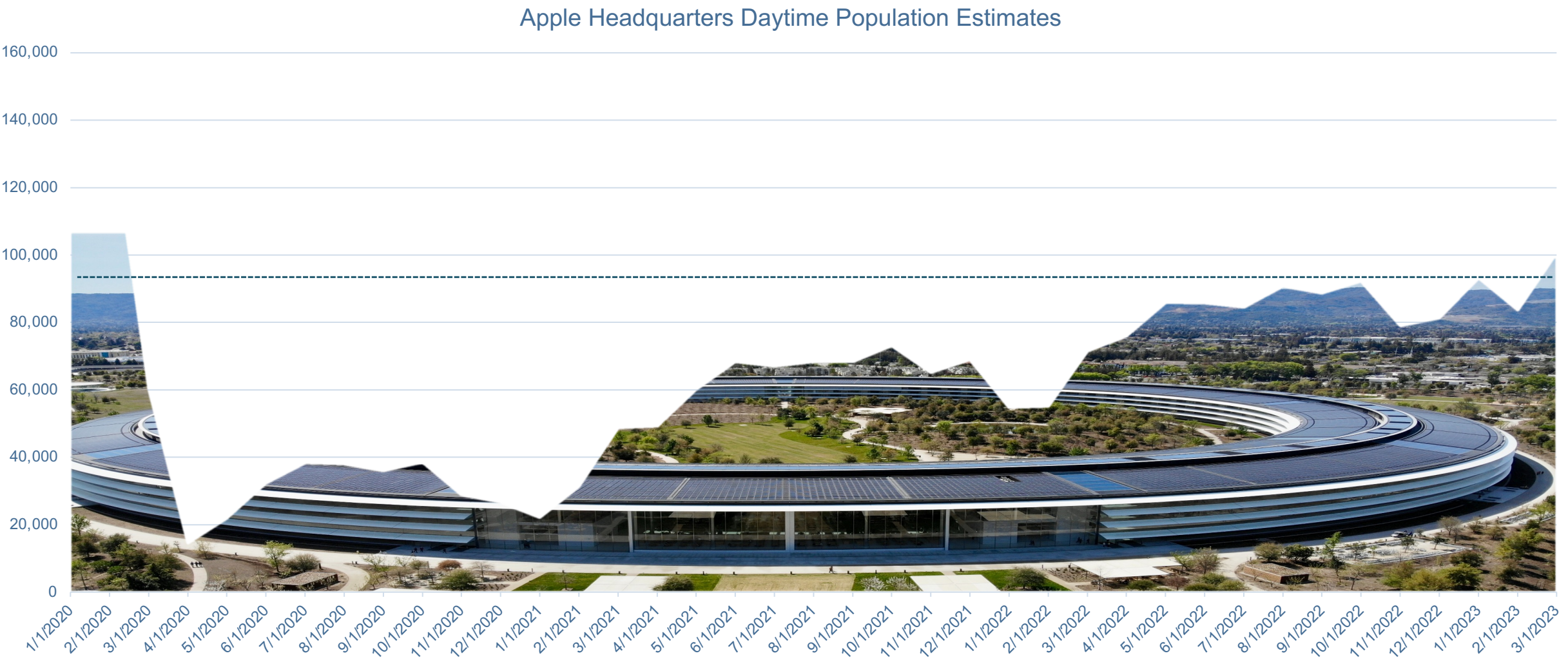
Return to office update: U.S. is the laggard



Companies are still “all over the map” with workplace strategies, but mostly settling on hybrid



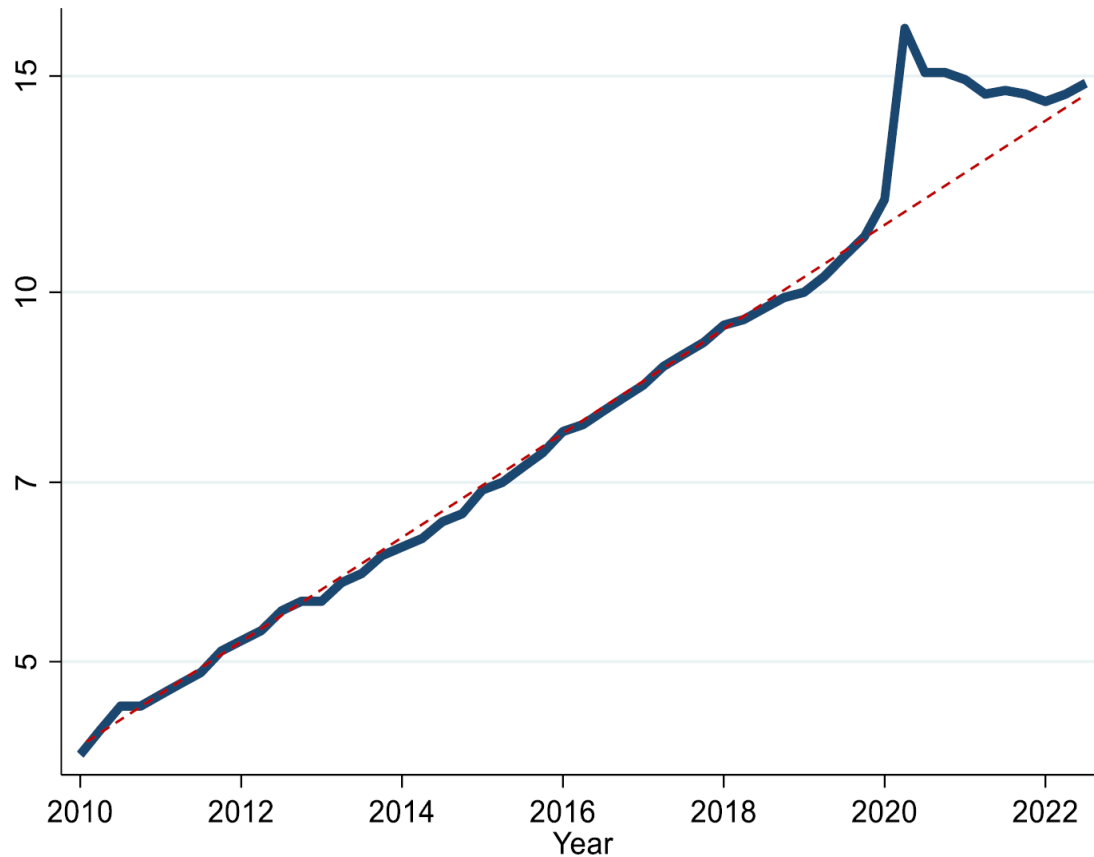
Apple HQ is above 70% of activity as of March 2023



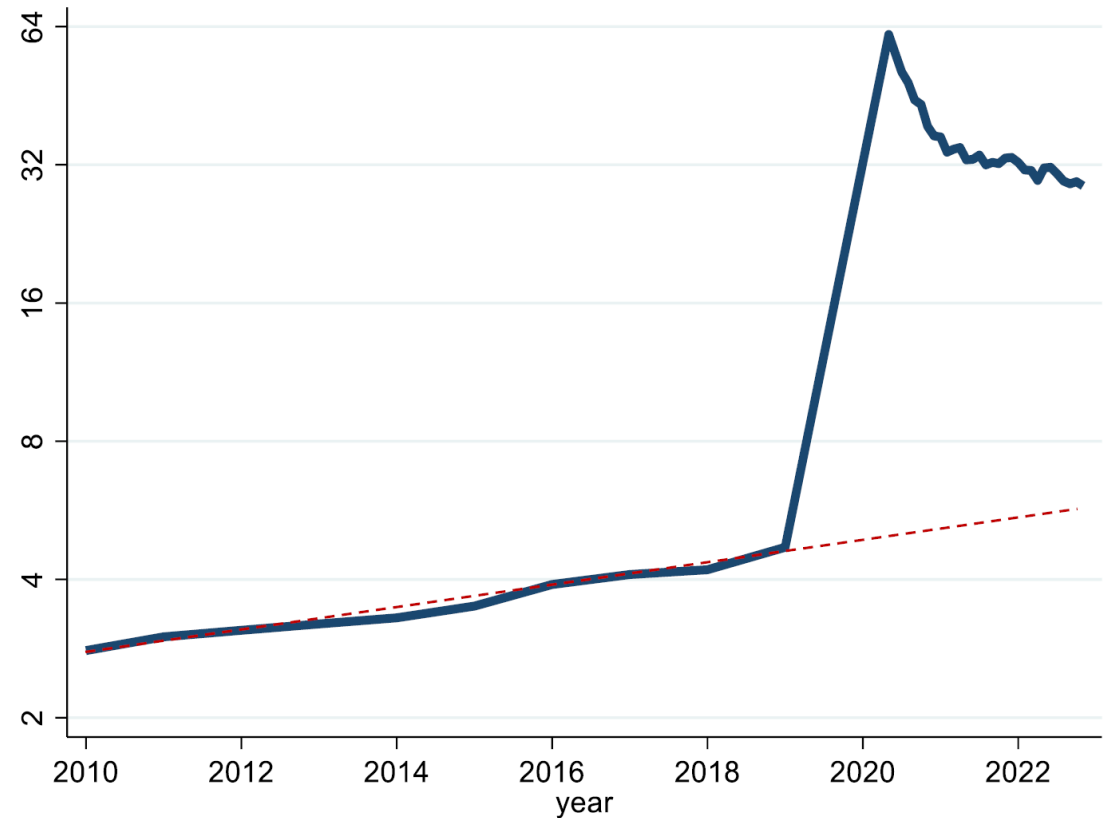
Source: Placer.AI, March 2023.

Is WFH / Hybrid work a structural shift or pandemic anomaly?

Share of retail spending online, %



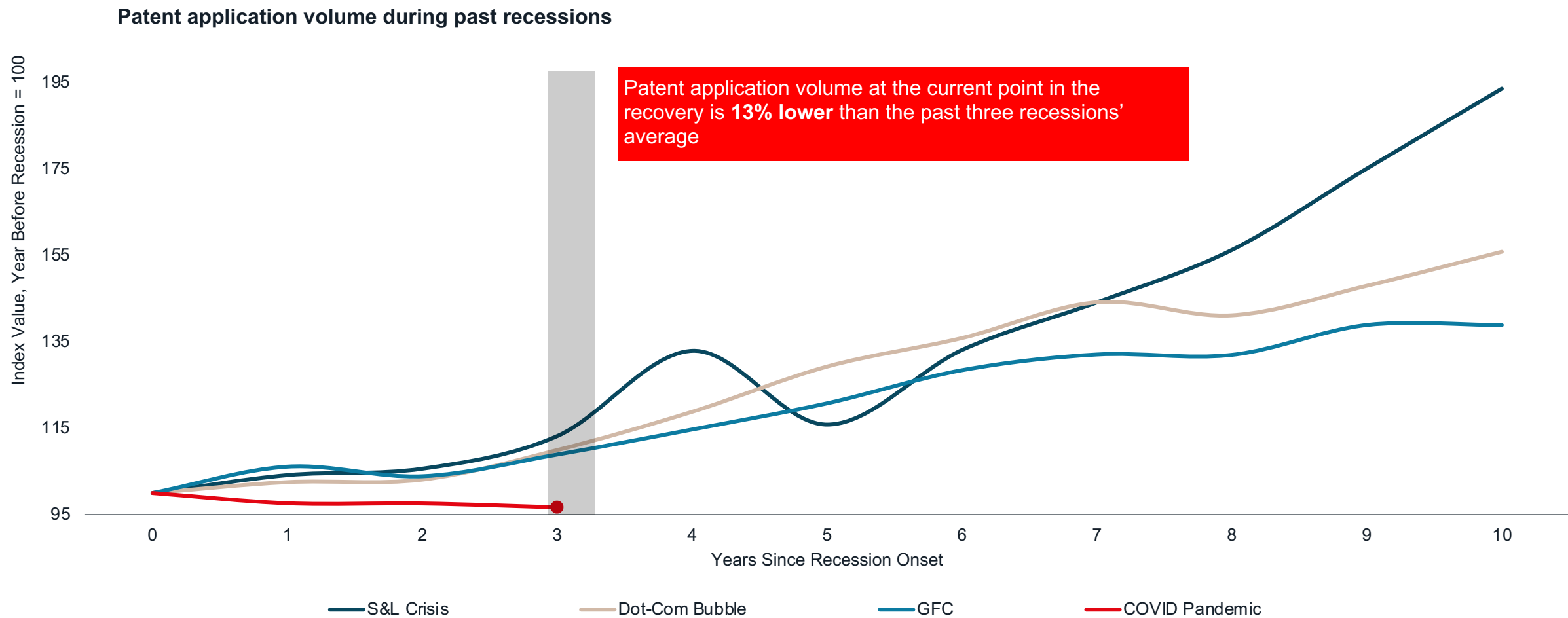
Share of days worked from home, %



Source: Retail data from the Census Bureau, quarterly seasonally adjusted <https://fred.stlouisfed.org/series/ECOMPCTSA>. WFH data from the Survey of Workplace Arrangements and Attitudes www.wfhresearch.com Both data cover the United States.

Remote working and performance

Concern is increasing around productivity for remote workers, especially those new to a role or company



Sources: Meta – TechCrunch; Oracle – Yahoo Finance

JLL Think - innovative approach to measuring actual performance

Neuroscience + AI + Workplace

JLL has partnered with EMOTIV to pilot state-of-the-art wearable technology that enables real-time bioinformatic insights into cognitive and emotional states



JLL Think – initial pilot analysis - “Brains work better together”

Best for engagement

The Office

Most cognitive load in data task
and best performance

The Office

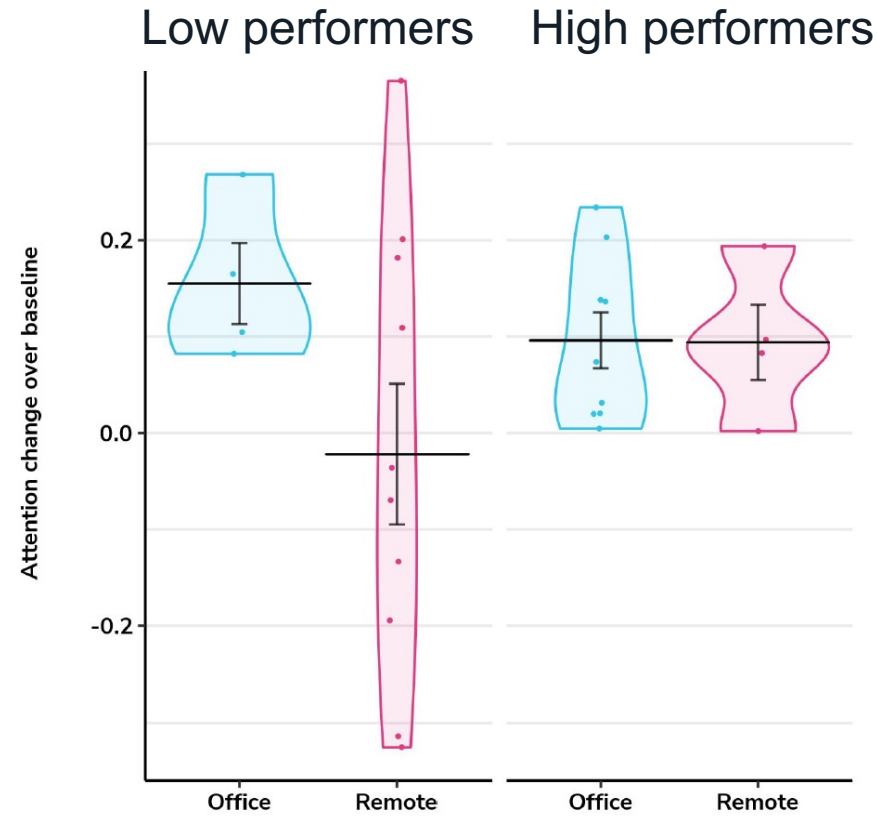
Most attention for seminar tasks

Remote

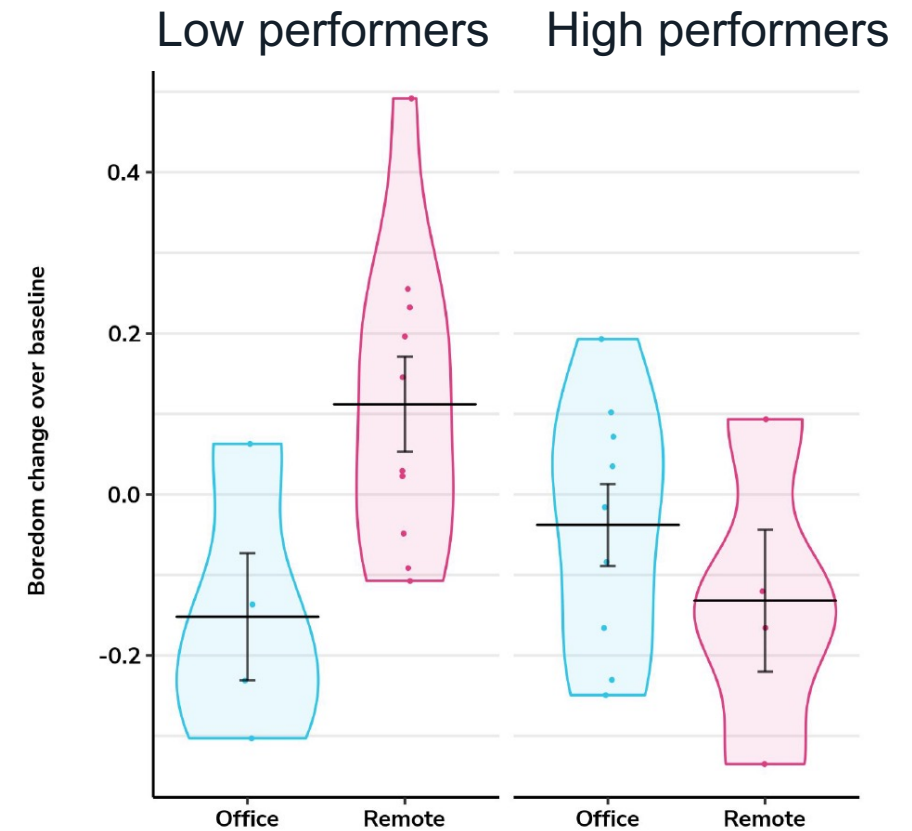
When our environment matches
the work

**Less bored and better
performance**

Attention



Boredom



More companies now pushing RTO mandates in Q1 2023 citing productivity, innovation and culture



Amazon

Amazon CEO updated Amazon employees on return to office plans on 2/17/2023, outlining the case, and value propositions of Amazon employees working together in person and in the office.



Bank of America

In mid-October, Bank of America issued a memo stating that employees will be required to be in offices three or more days per week depending on role and function.



Disney

Employees will be required to work from the office four days per week starting in March 2023.



General Motors

In early Q4, GM delayed a previously-announced three day per week in-office attendance policy which will now take effect beginning in Q1 2023 due to employee pushback.



IBM

IBM Consulting announced employees located near offices or client sites are expected to work three days per week from the office.



Pfizer Inc.

Pfizer's U.S. workforce will be required to work from the office two or three days per week beginning in January 2023.



Salesforce

Reversing a remote-first work policy, effective January 2023 Salesforce employees will be required to work from the office a minimum of three days per week.



Snap Inc.

Beginning in the new year, Snap's U.S. employees will be required to work in offices four days per week, after previously allowing full-time remote work.



Starbucks

Announced in January, employees "within commuting distance" will be required to return to offices a minimum of three days per week starting January 31, 2023.



Twitter

After laying off 50% of staff, Elon Musk issued a five day per week return-to-office mandate for remaining employees.



Uber Technologies

Uber announced all non-remote employees must work from the office on Tuesdays and Thursdays, effective Nov. 1, 2022.



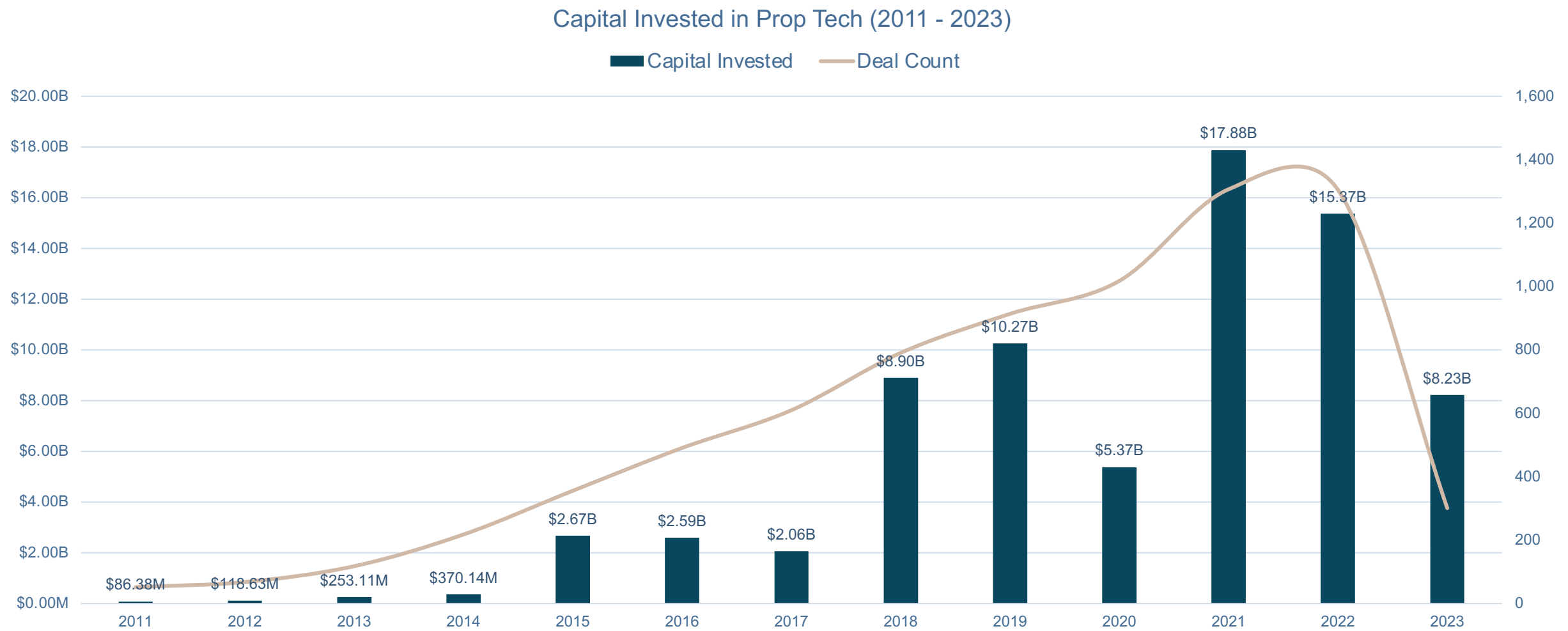
U.S. Bank

CEO Andy Cecere asked employees to return to offices three days per week, with a formal policy to follow in Q1 2023.



State of PropTech

Investment in PropTech grew substantially over the previous decade and started to slow in 2022. Despite a large deal to Better.Com, investment in PropTech is down to early 2016 – 2017 levels.



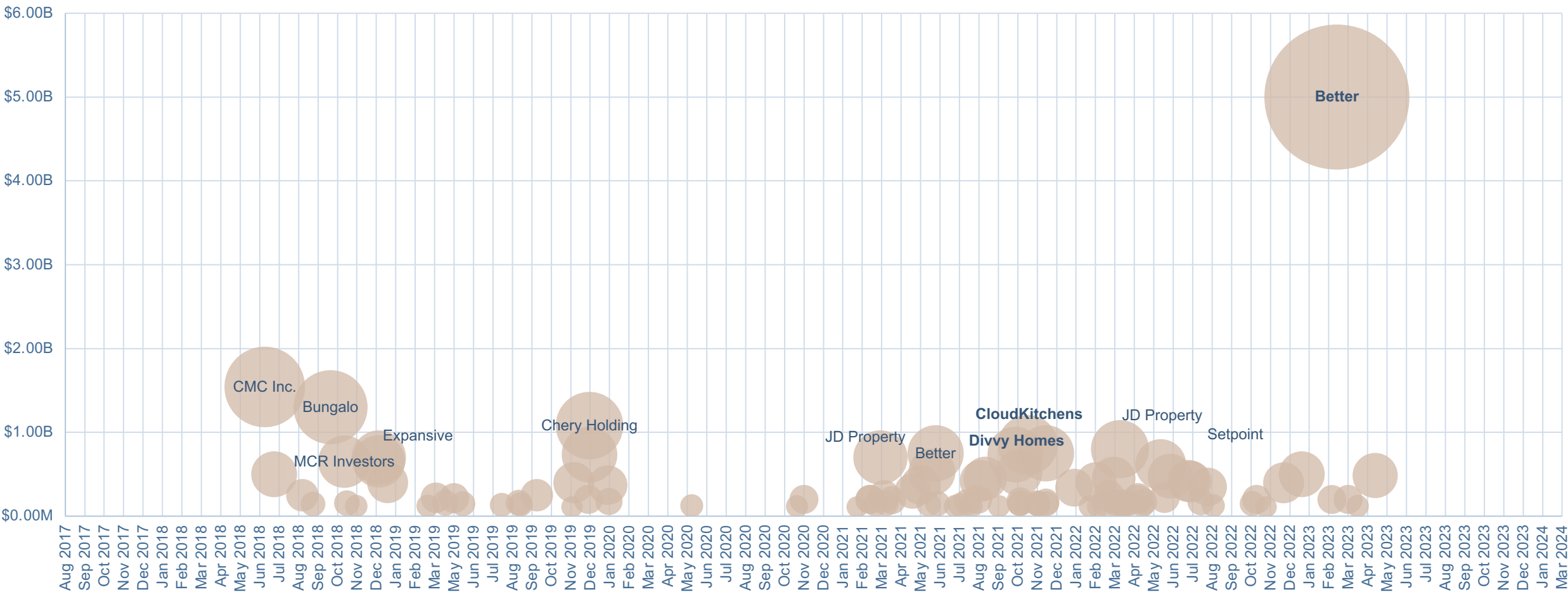
Total investment in real estate sector by year. Includes VC, private equity, and other sources of capital.

Source: Pitchbook, 2023

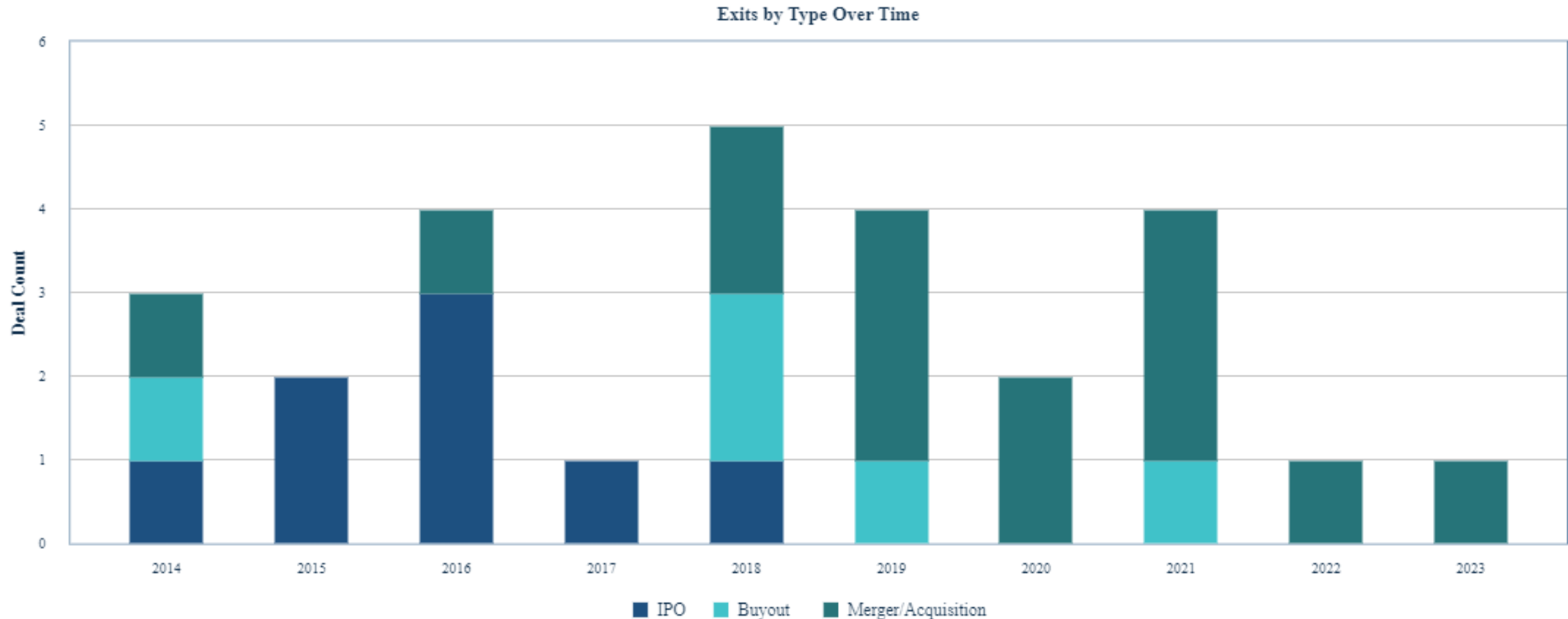


Better.Com received a large injection of capital skewing 2023 numbers upward in an otherwise more muted funding environment.

Top 100 PropTech Investments by Quarter



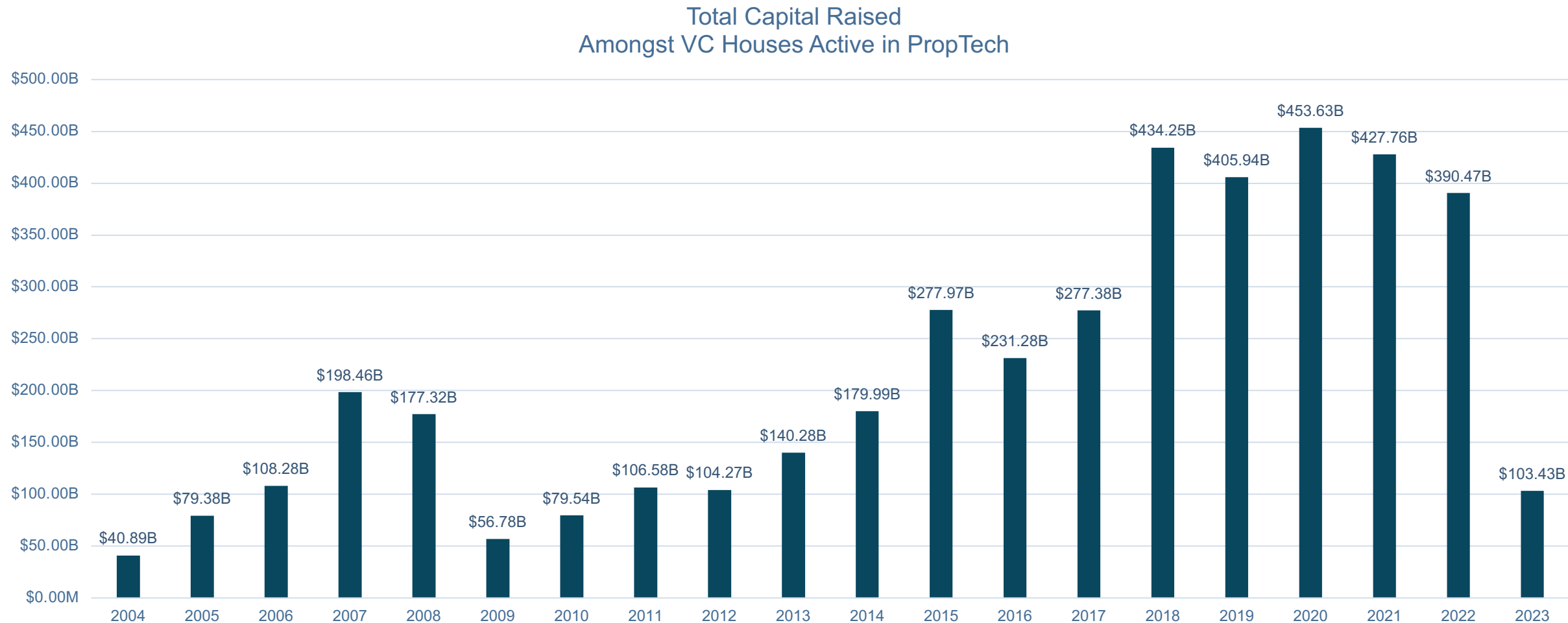
As with venture capital conditions overall, the exit environment has slowed considerably with the last two years dominated by merger and acquisitions.



Source: PitchBook Data

PitchBook

Investment pools started to decrease after a massive ramp in raised capital in 2018 – 2021. 2023 shows a considerable slowdown in available dry powder.



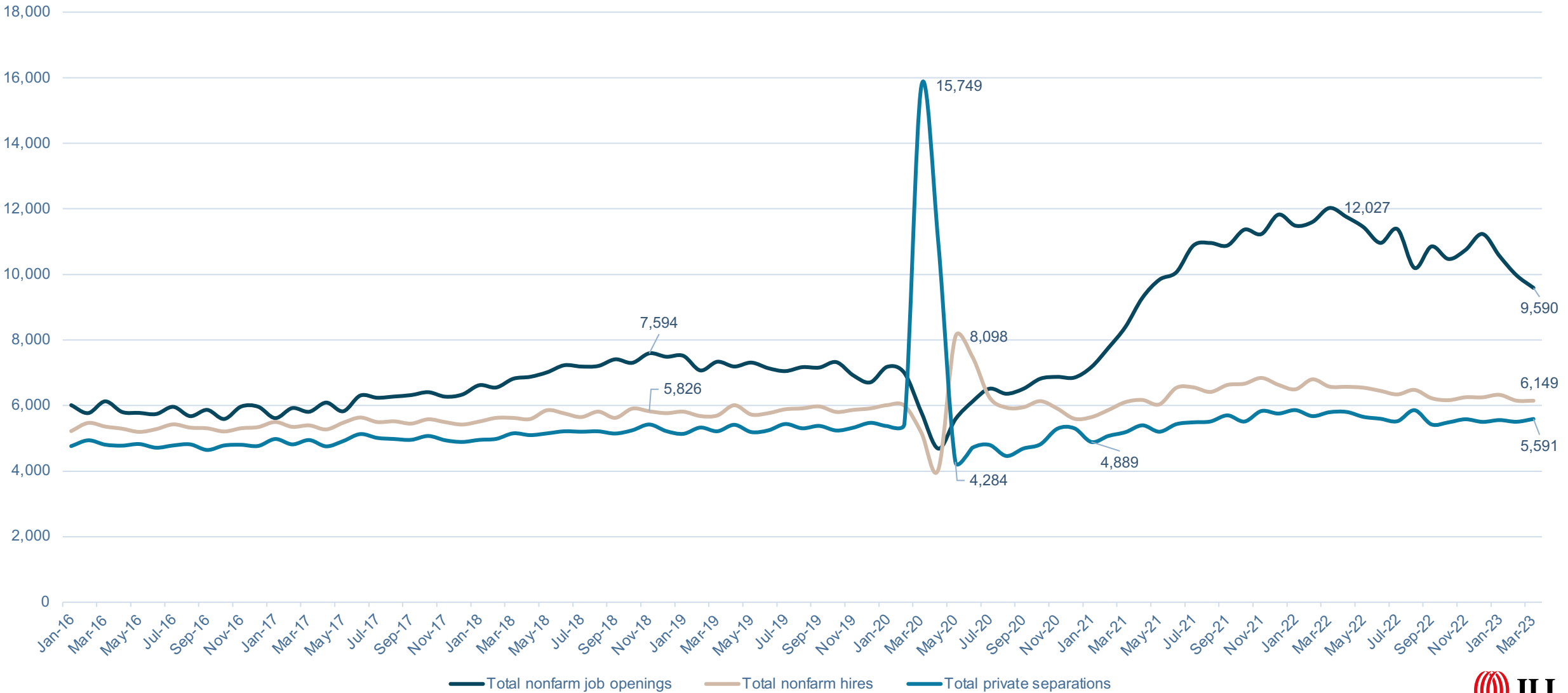
Source: Pitchbook, 2023

Outlook and implications

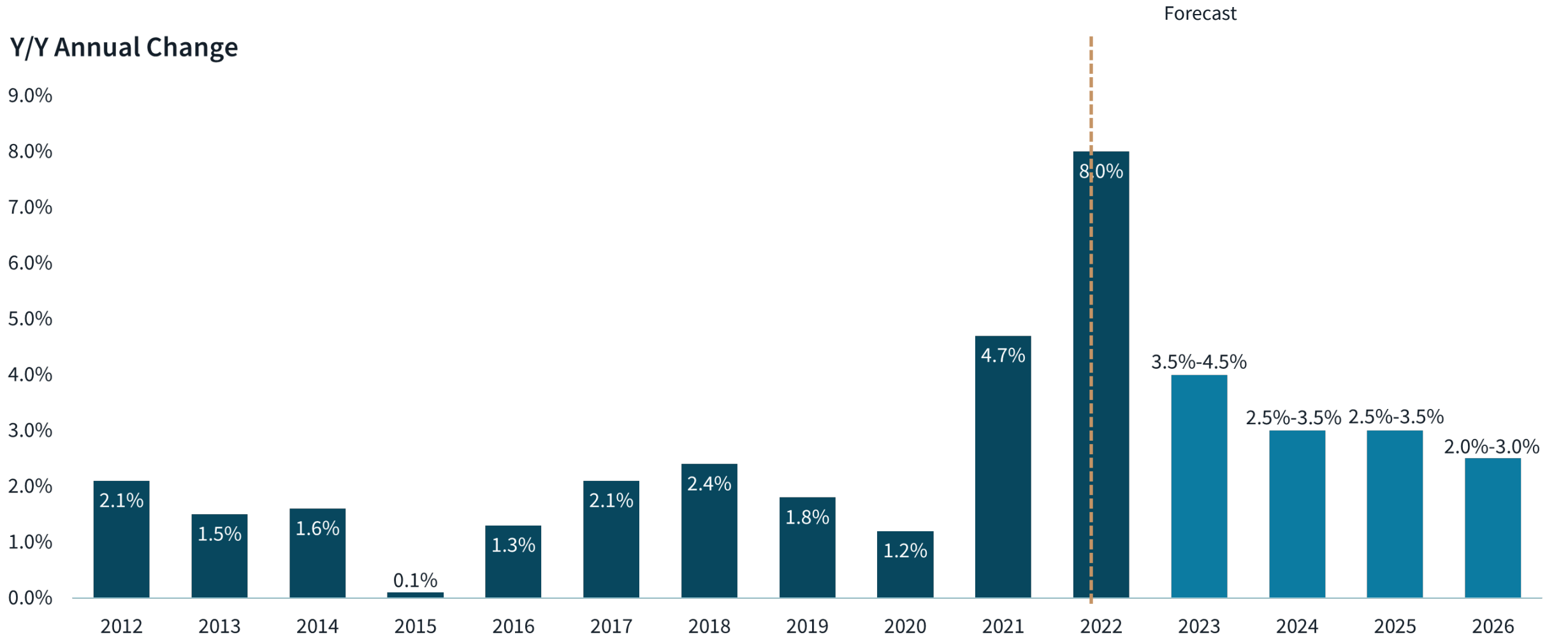


Labor market remains tight, but layoffs are mounting

U.S. Hiring, Separations, and Jobs Postings (2015 - March 2023)



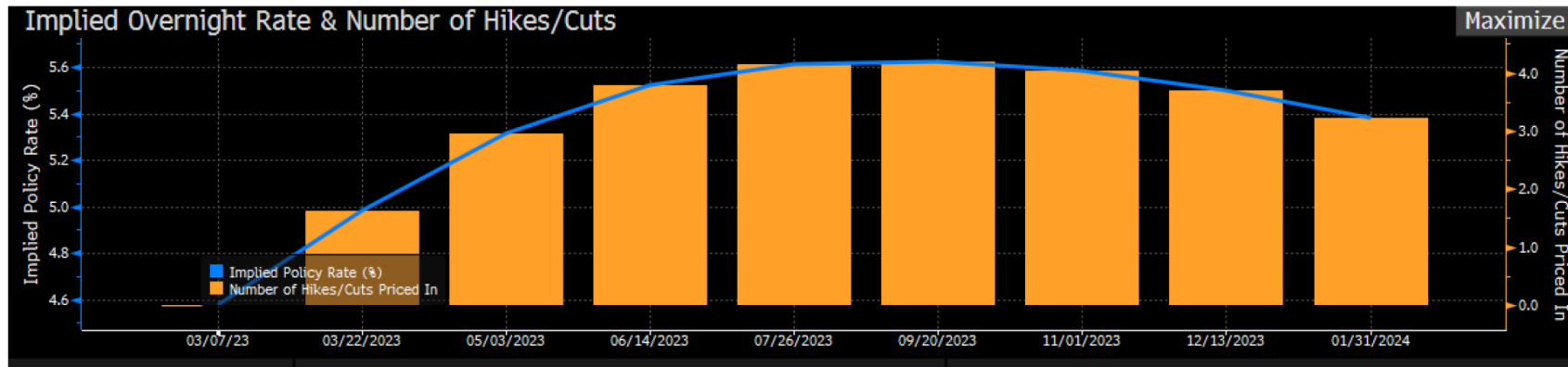
We've passed peak inflation, but still above the Fed's target



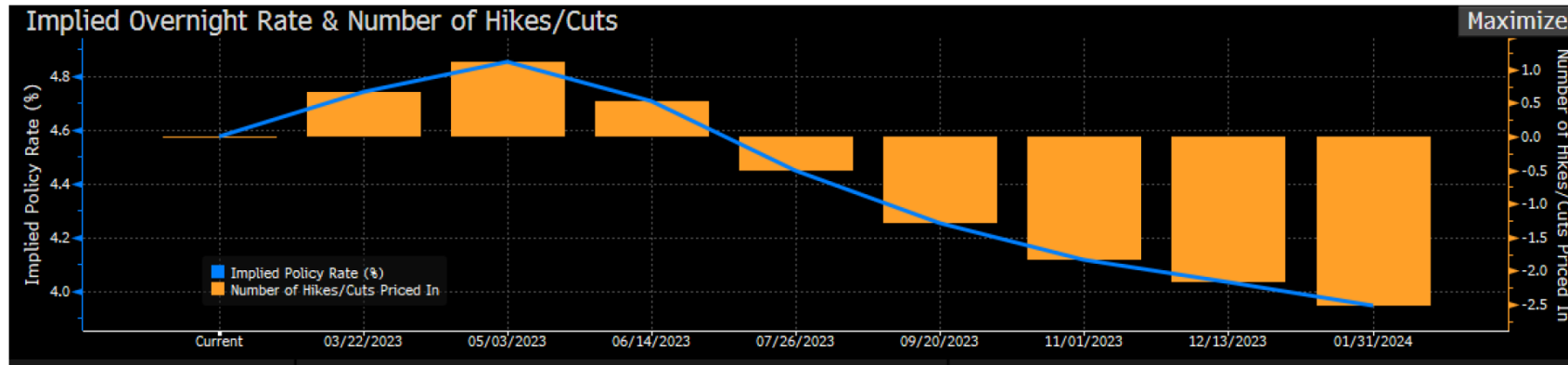
Markets see a Fed pivot

Forward curve suggests dramatic shift in the rate path

March 7th, 2023

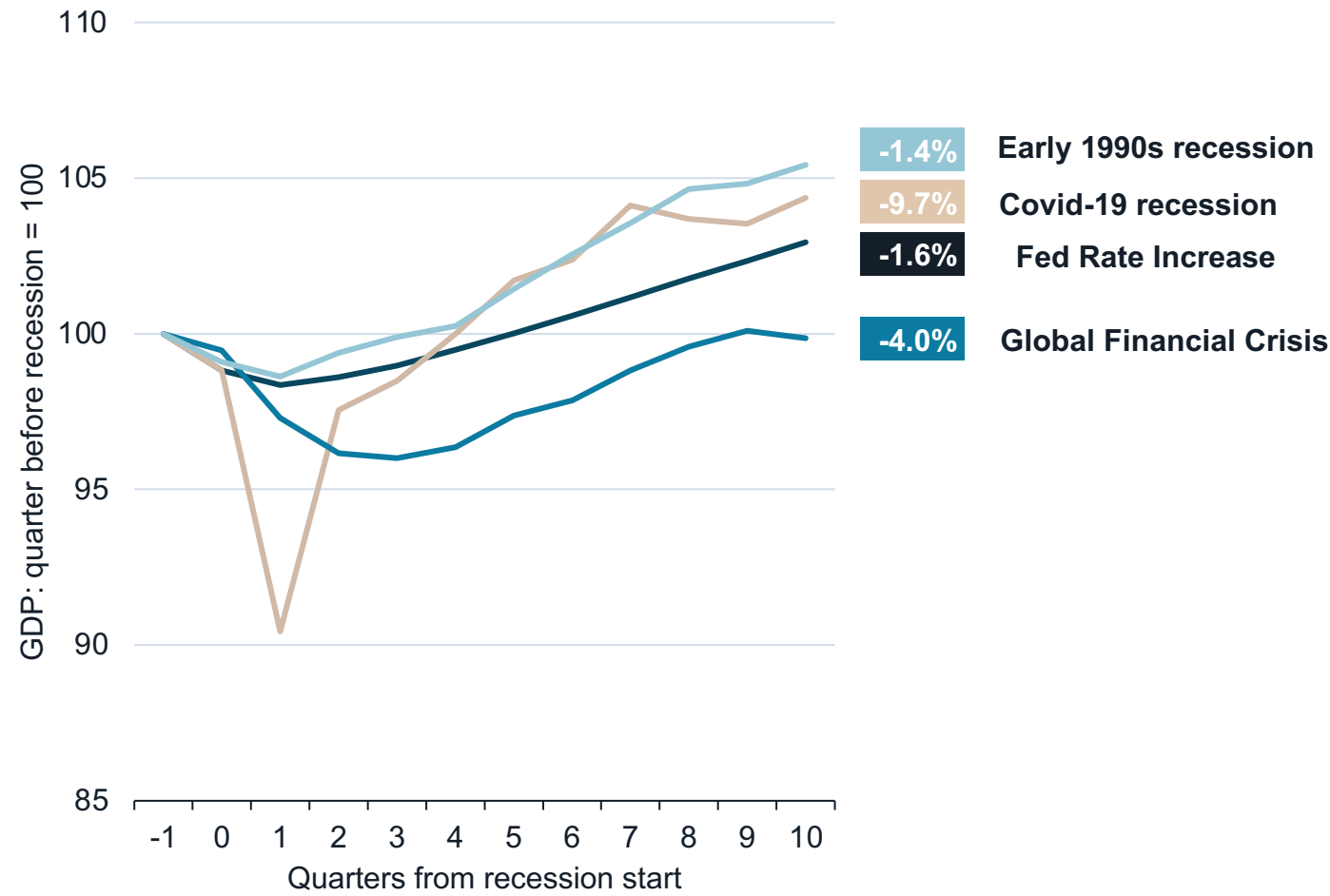


March 17th, 2023

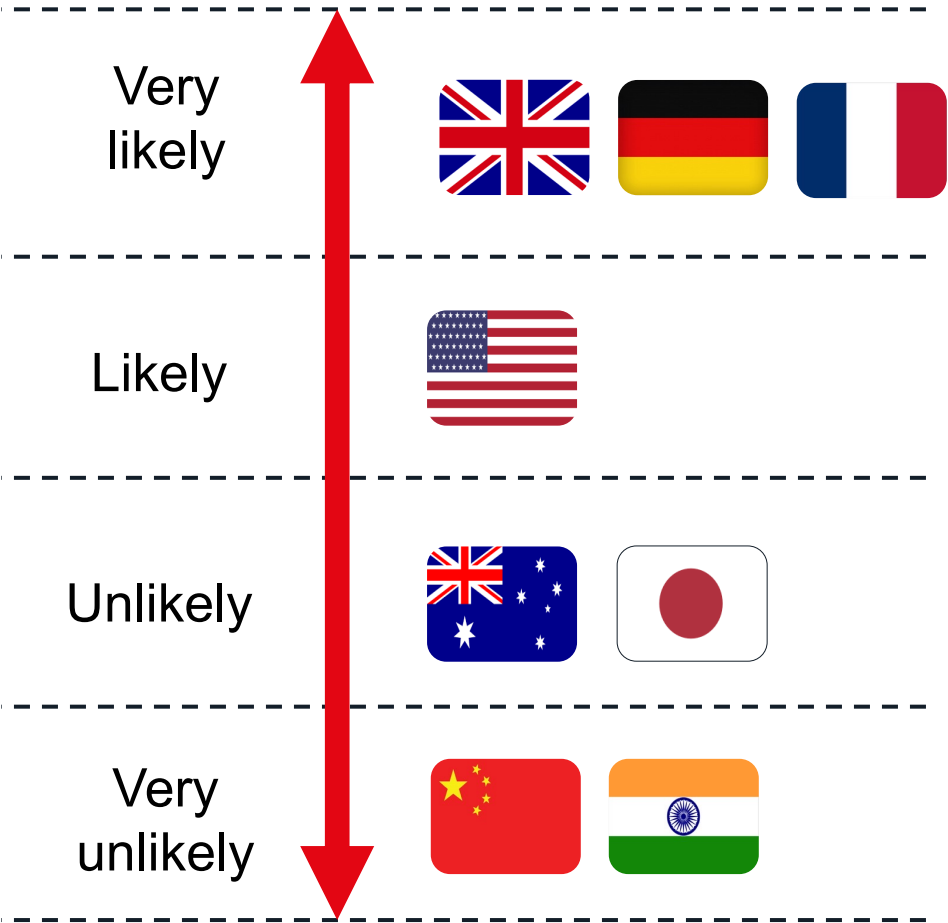


How bad is it going to get?

Recession profile and peak-to-trough decline in GDP



2023 recession probability



Thank you

Alexander Quinn
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Northern California