

2013 Marquette University Real Estate Strategies Conference



MARQUETTE
UNIVERSITY

College of Business Administration
Center for Real Estate

2013 Marquette University Real Estate Strategies Conference

Economic Forecast

Dr. Mark Eppli

Interim Keyes Dean in Business Administration and Bell Chair in Real Estate

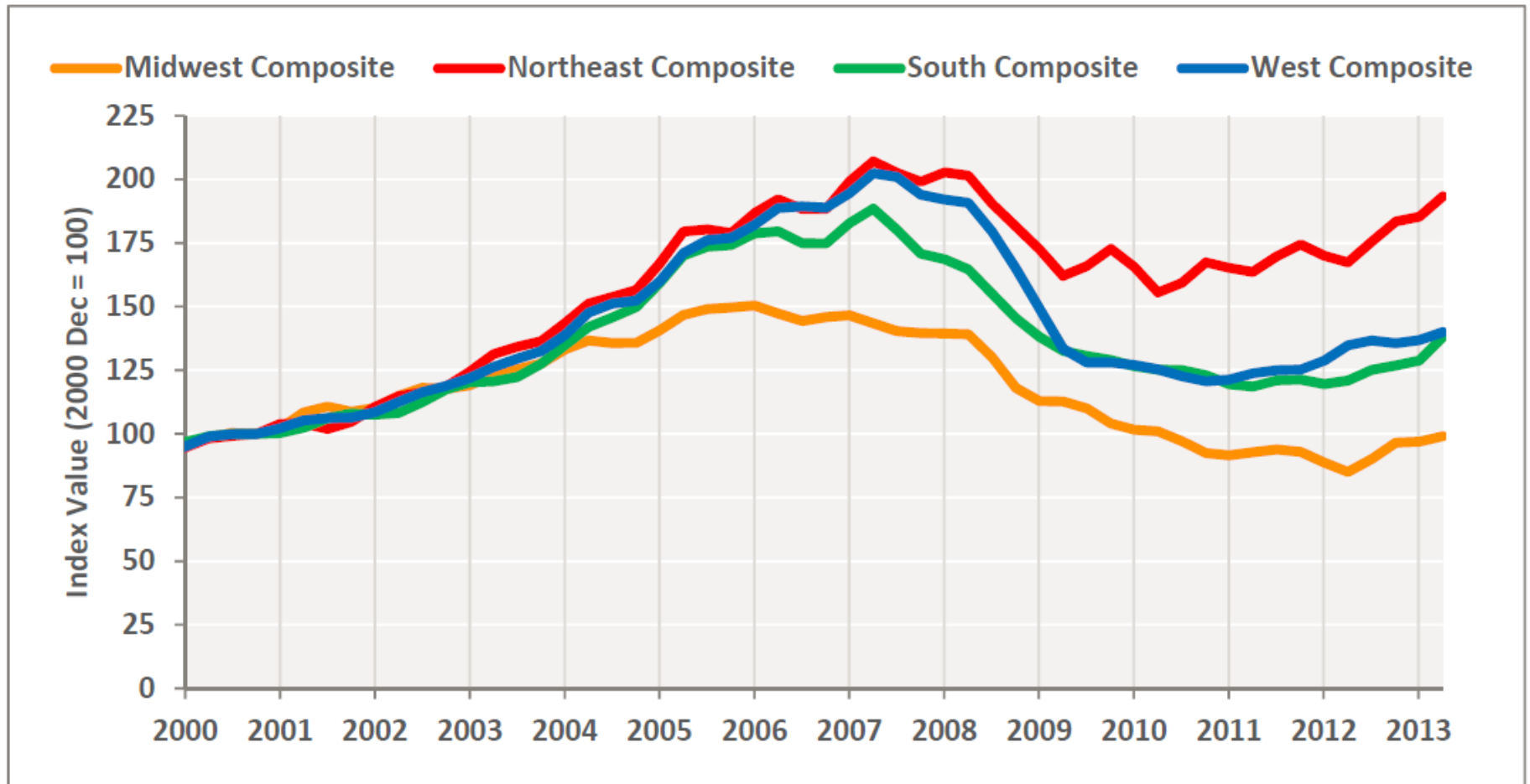
Equity Investment Strategies

Mark J. Eppli
Interim Keyes Dean and Bell Chair in Real Estate
Marquette University

September 12, 2013

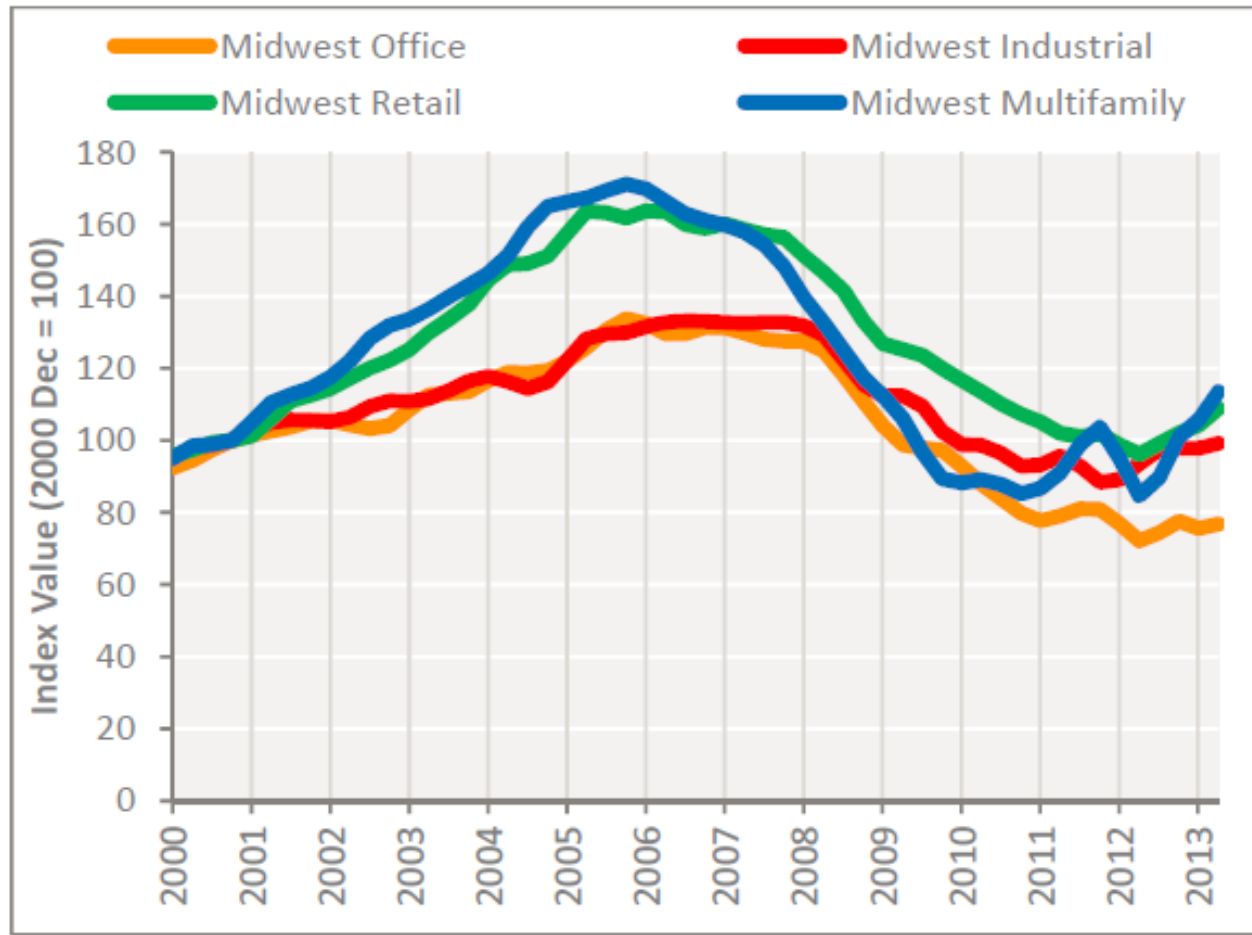
Is the Midwest a value proposition or structurally out of favor?

U.S. Regional Type Quarterly Indices - Equal Weighted, Data through June of 2013

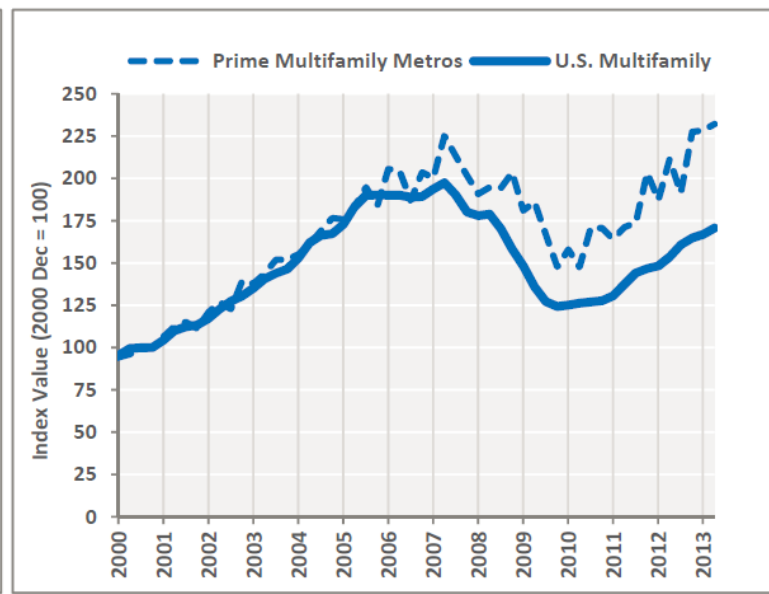
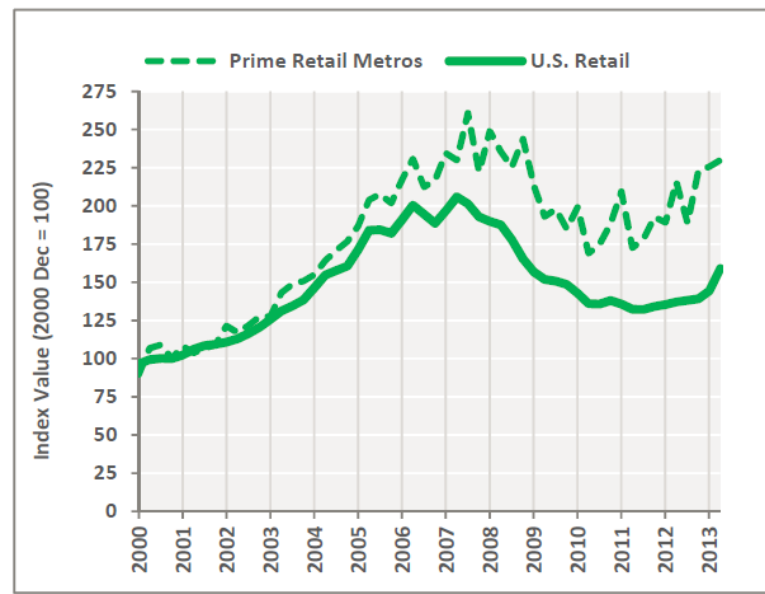
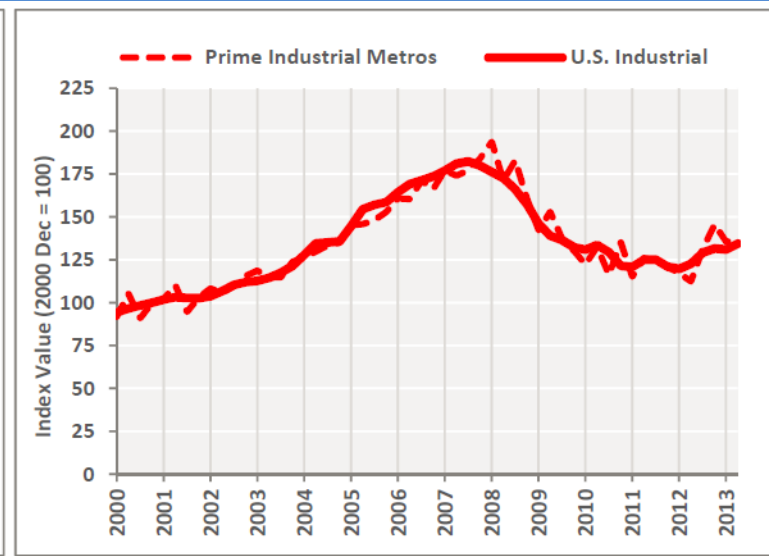
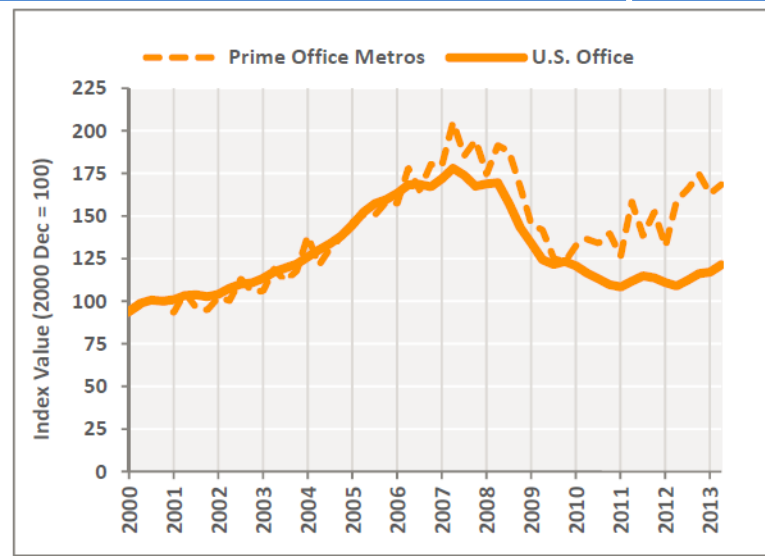


Which property type provides the greatest opportunity?

U.S. Midwest Property Type Quarterly Indices – Equal Weighted, Data through June of 2013



Or should one forgo the Midwest markets for the lower cap rate prime markets?

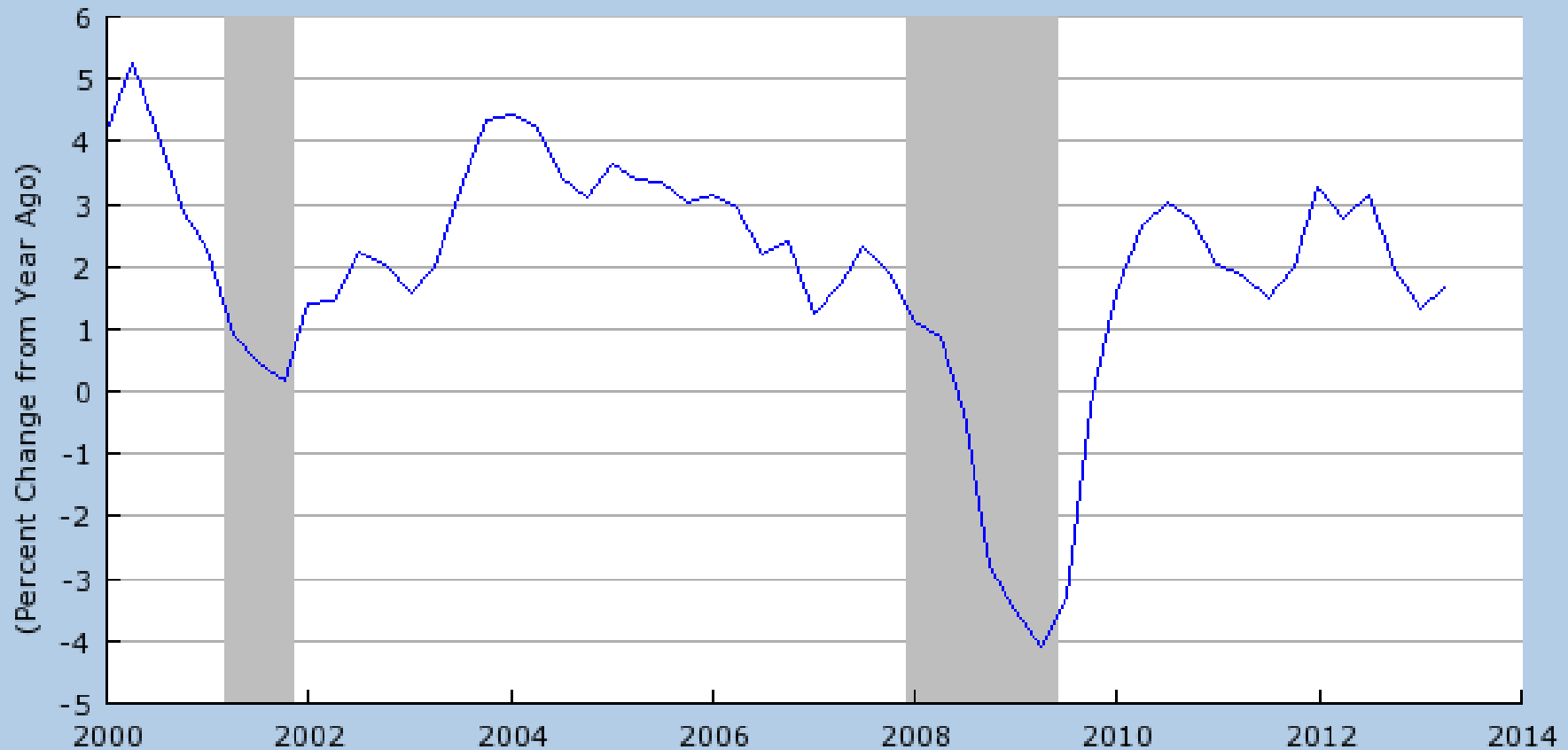


The Fundamentals: Growth

GDP Growth

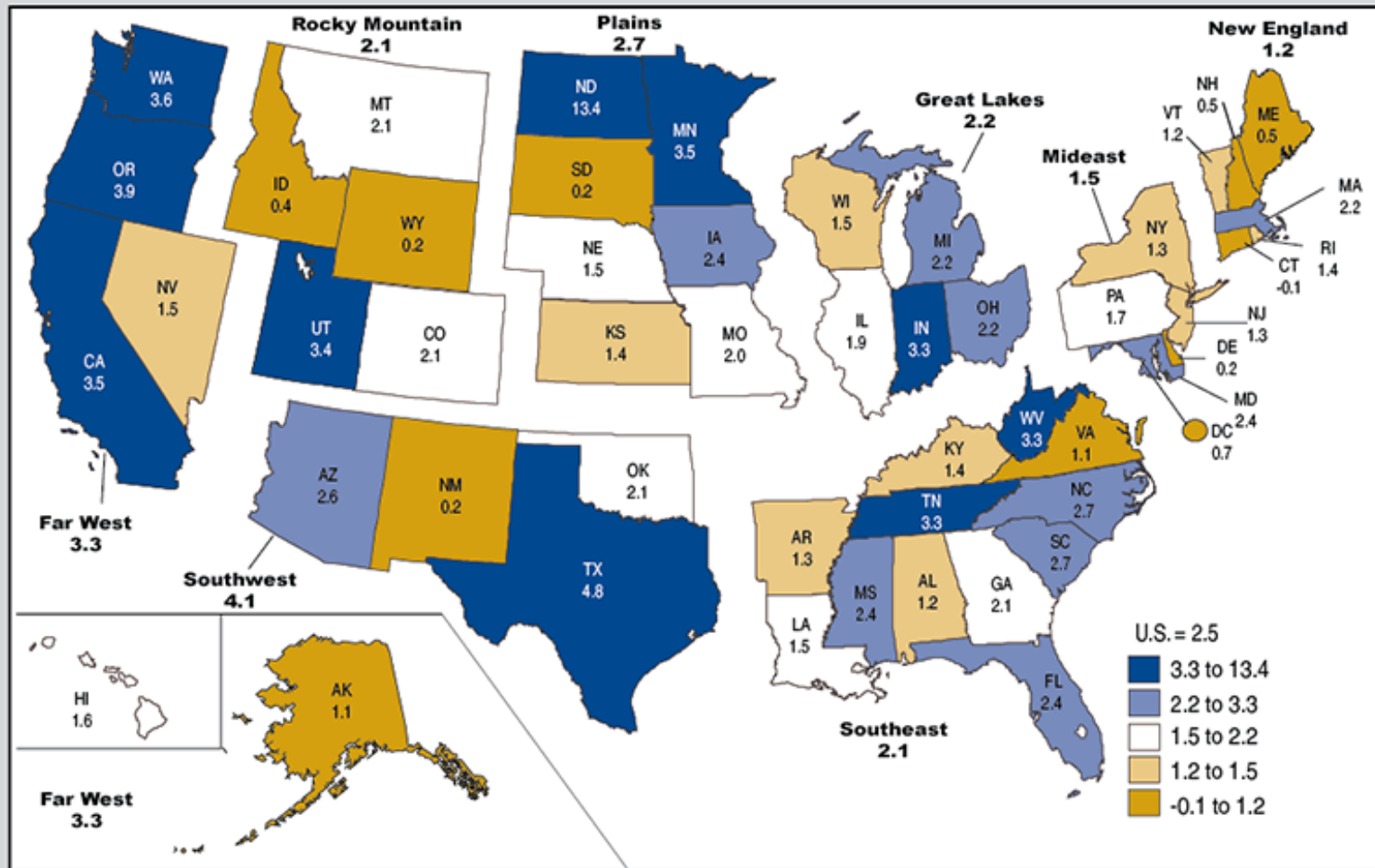
Real Gross Domestic Product (GDPC1)

Source: U.S. Department of Commerce: Bureau of Economic Analysis



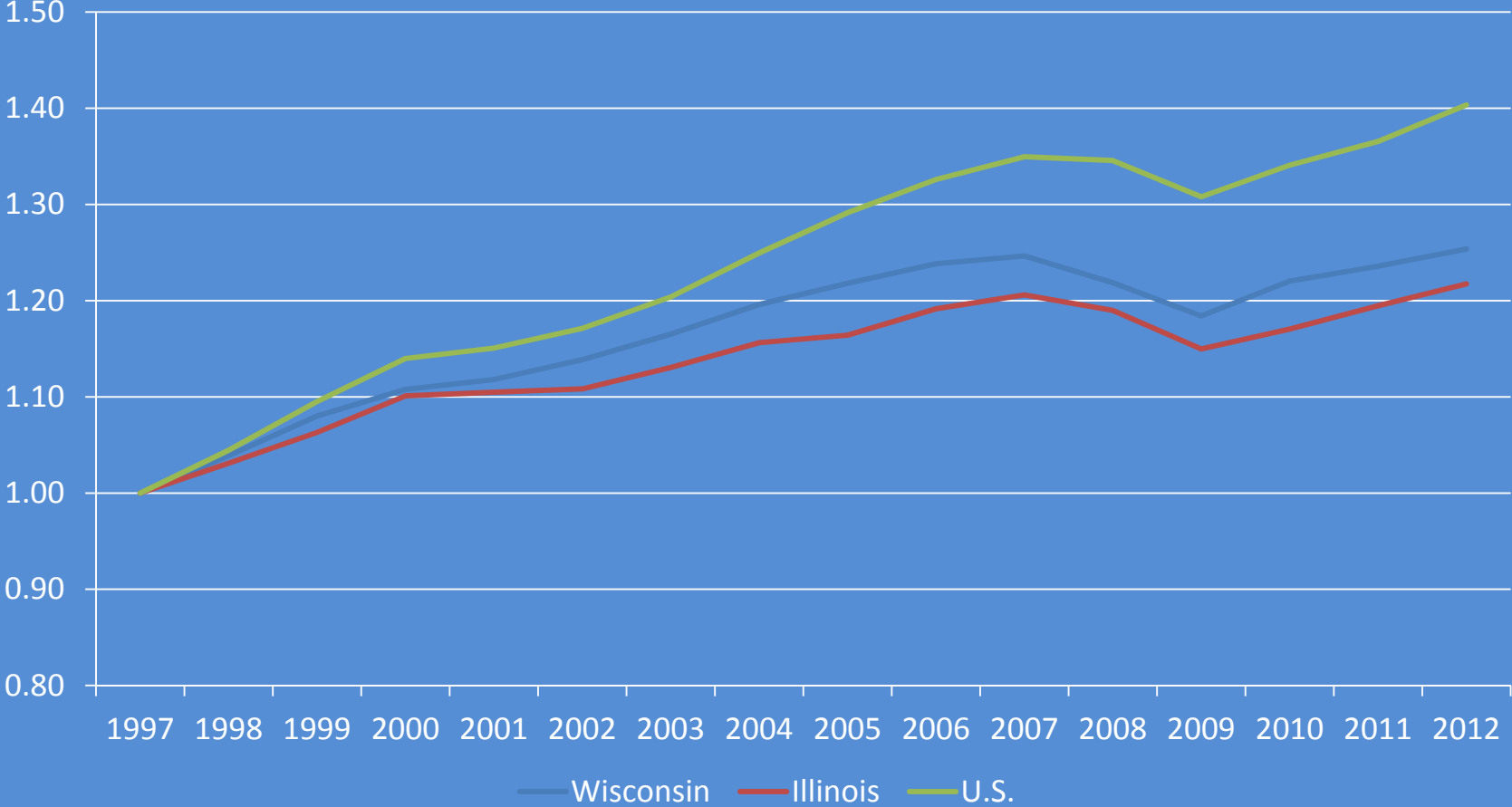
Shaded areas indicate US recessions.
2013 research.stlouisfed.org

Percent Change in Real GDP by State, 2012



Economic growth in Wisconsin and Illinois has lagged that of the U.S.

GDP Growth for Wisconsin, Illinois, and the U.S., 1997-2012

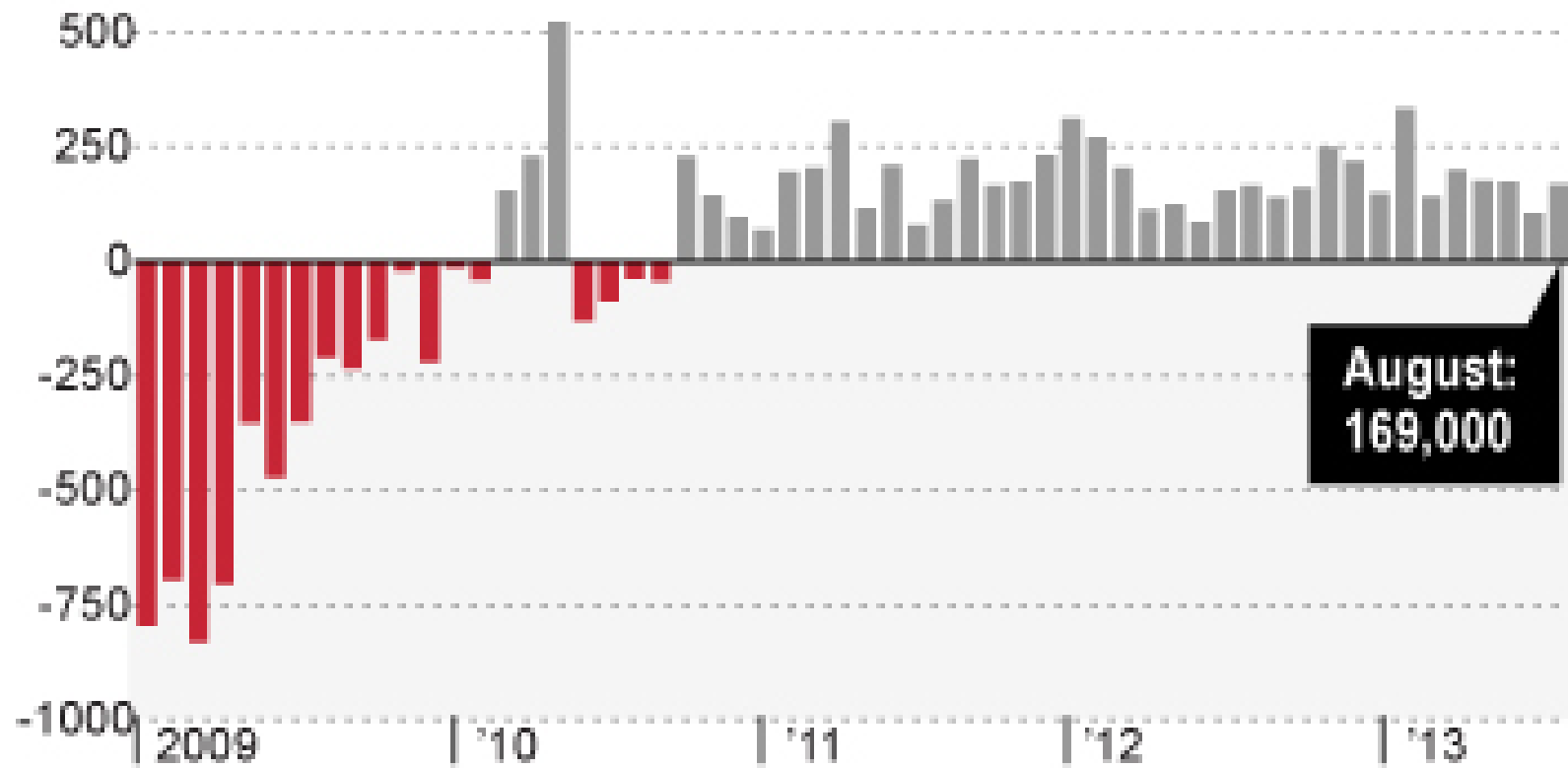


Source: Federal Reserve and Marquette University.

Nationally, jobs are making a slow recovery

Monthly Change in Nonfarm Payrolls

in thousands

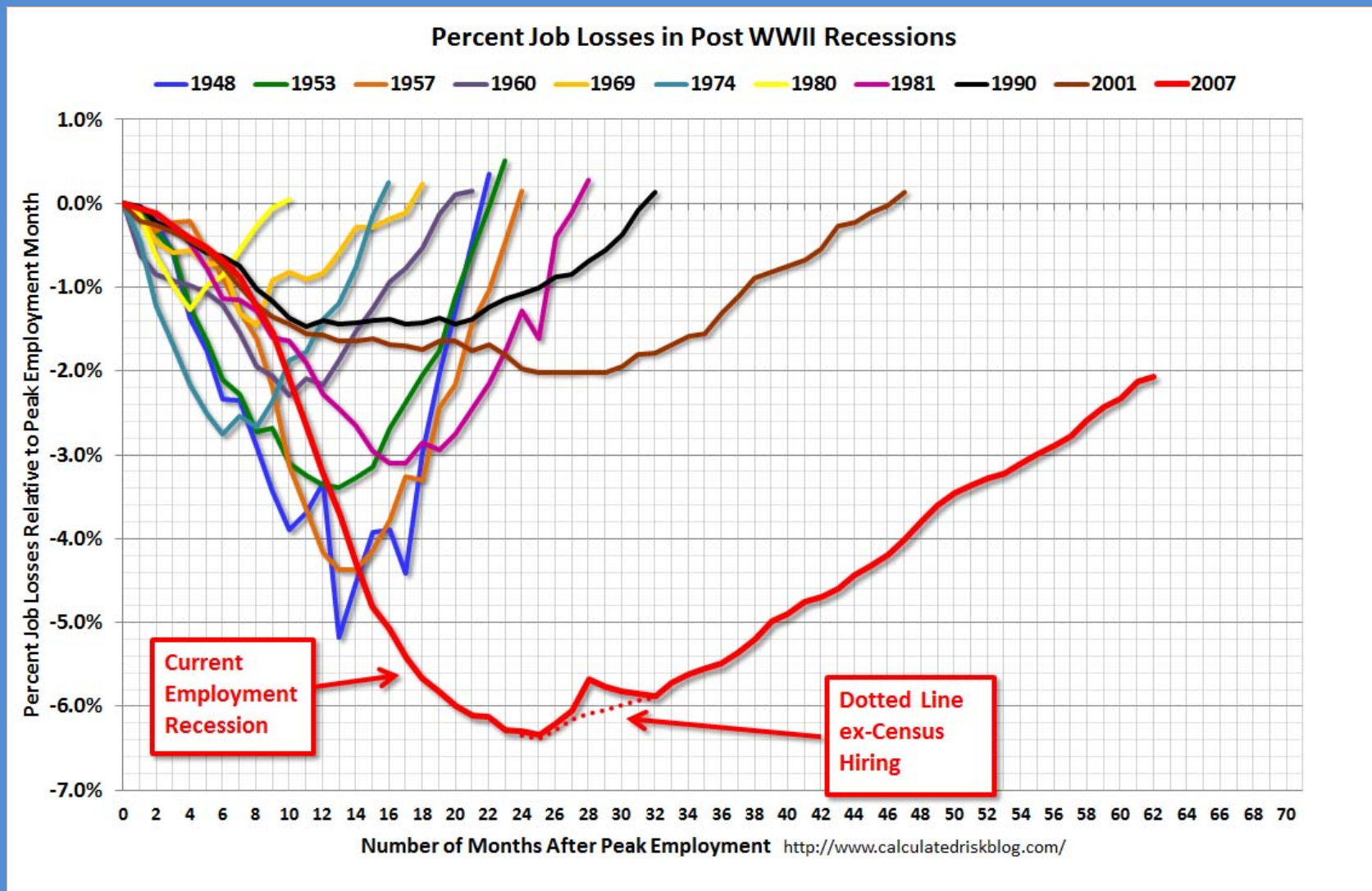


August:
169,000

Source: Labor Department

Source: WSJ, September 6, 2013.

The U.S. has recovered about 2/3rds of the jobs lost in the recession



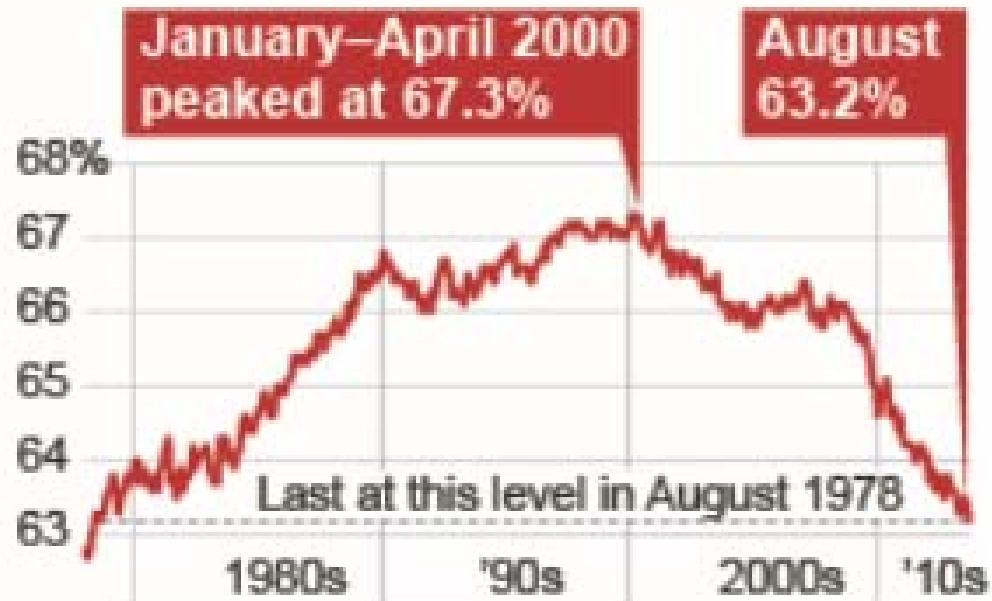
While the unemployment rate has dropped to 7.3%, how do we account for labor force participation rates

More Jobs, Fewer Workers

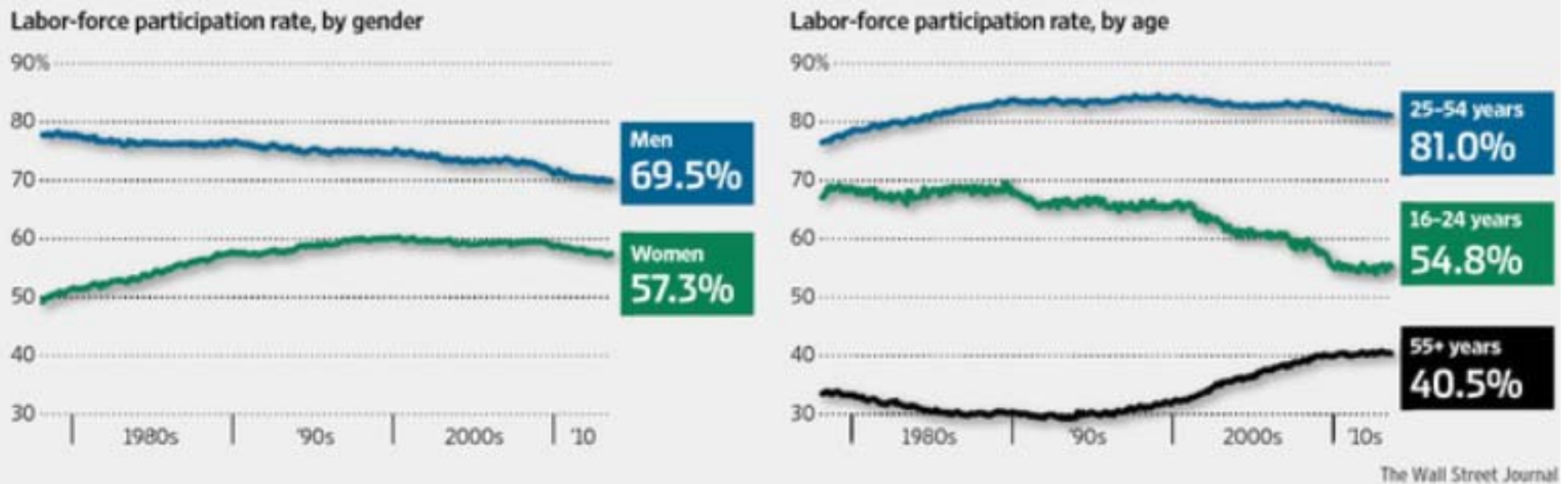
Monthly change in nonfarm payrolls, in thousands



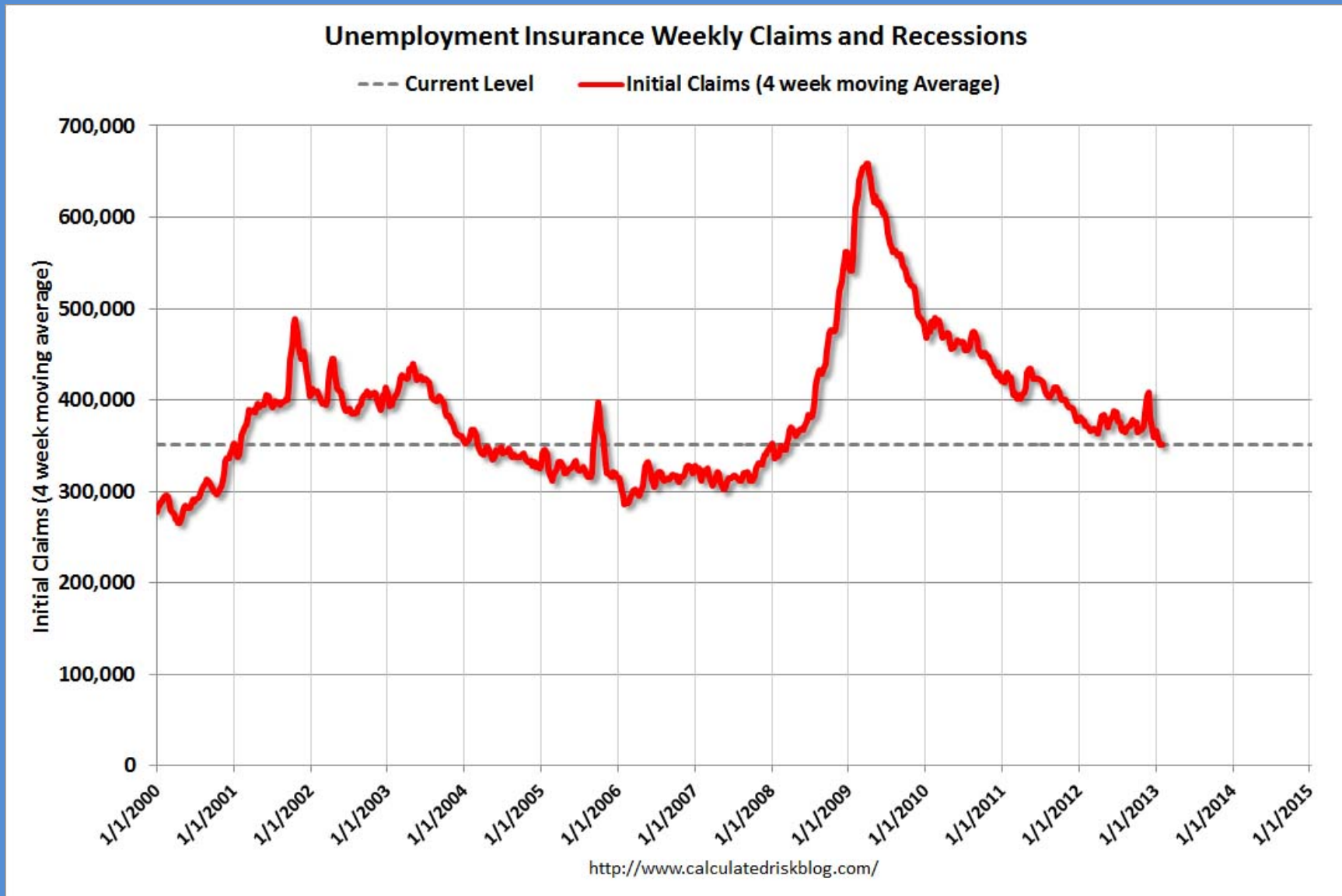
Labor-force participation rate
Share of the population working or looking for work



What part of the drop labor force participation rates is retiring baby boomers?

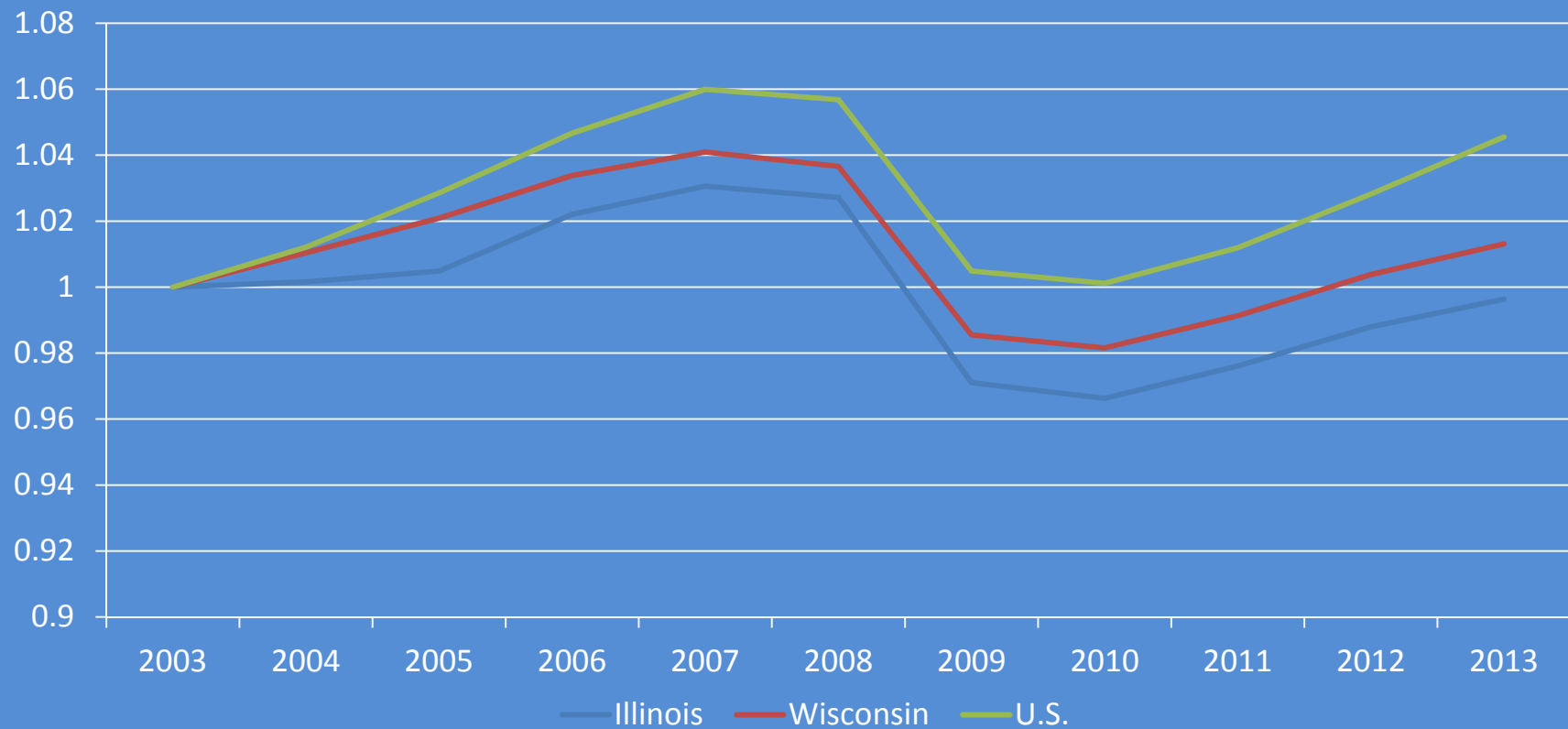


The potential for increased hiring looks promising



Wisconsin and Illinois employment growth has lagged that of the U.S.

Employment Growth in Illinois, Wisconsin, and the United States (July 2003-July 2013)



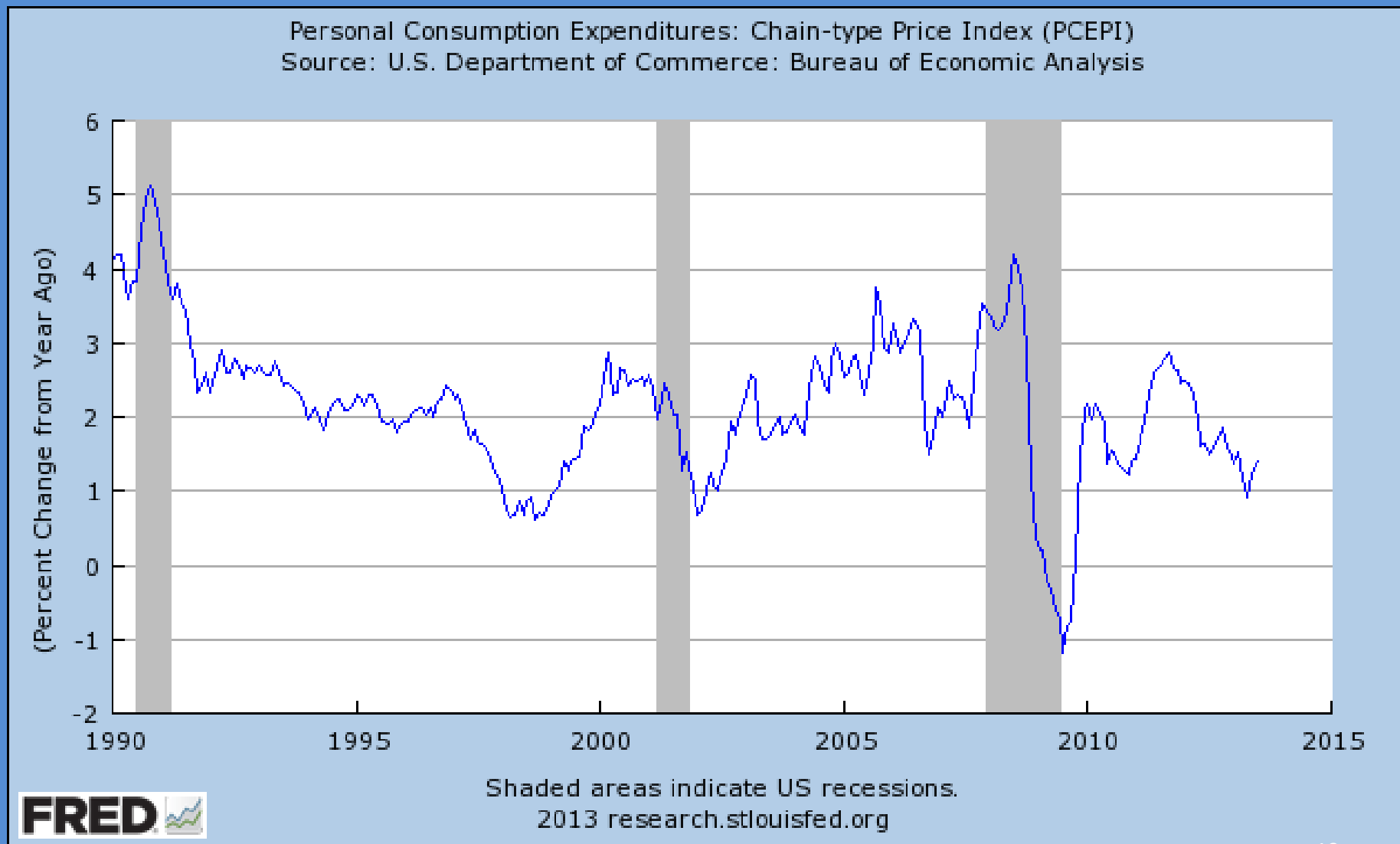
Expected population growth for Wisconsin and Illinois is well below the 29% national average 2000-2030

Change: 2000 to 2030 State	Change: 2000 to 2030 Number	Change: 2000 to 2030 Percent	Change: 2000 to 2030 Rank in percent change
.New Mexico	280,662	15.4	26
.Missouri	834,962	14.9	27
.Wisconsin	787,089	14.7	28
.Oklahoma	462,597	13.4	29
.Kentucky	513,229	12.7	30
.Indiana	729,623	12.0	31
.Maine	136,174	10.7	32
.Massachusetts	662,912	10.4	33
.Rhode Island	104,622	10.0	34
.Alabama	427,143	9.6	35
.Kansas	251,666	9.4	36
.Mississippi	247,752	8.7	37
.Connecticut	283,065	8.3	38
.Illinois	1,013,599	8.2	39
.Michigan	755,728	7.6	40
.Louisiana	333,657	7.5	41

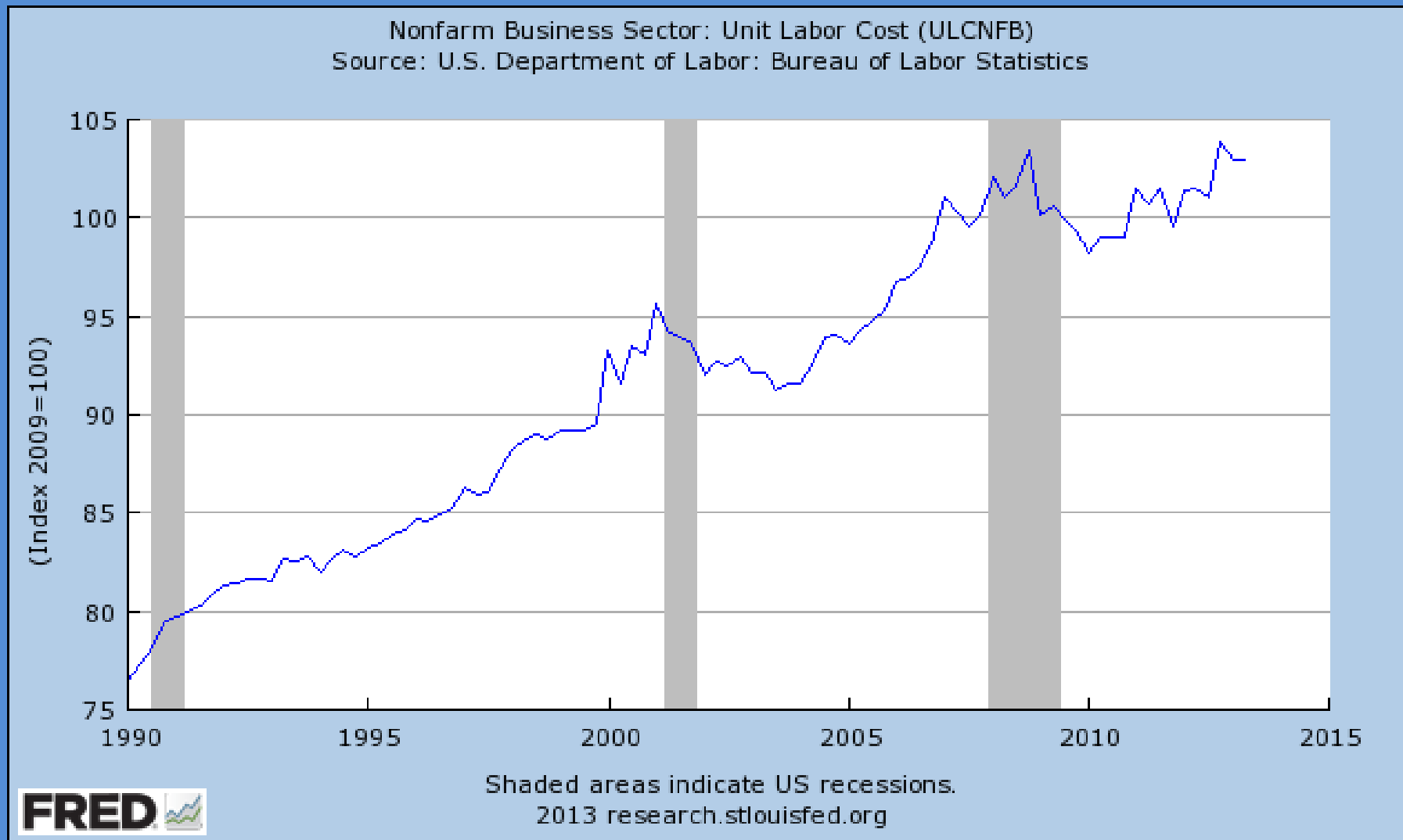
Source: U.S. Census Bureau.

Inflation

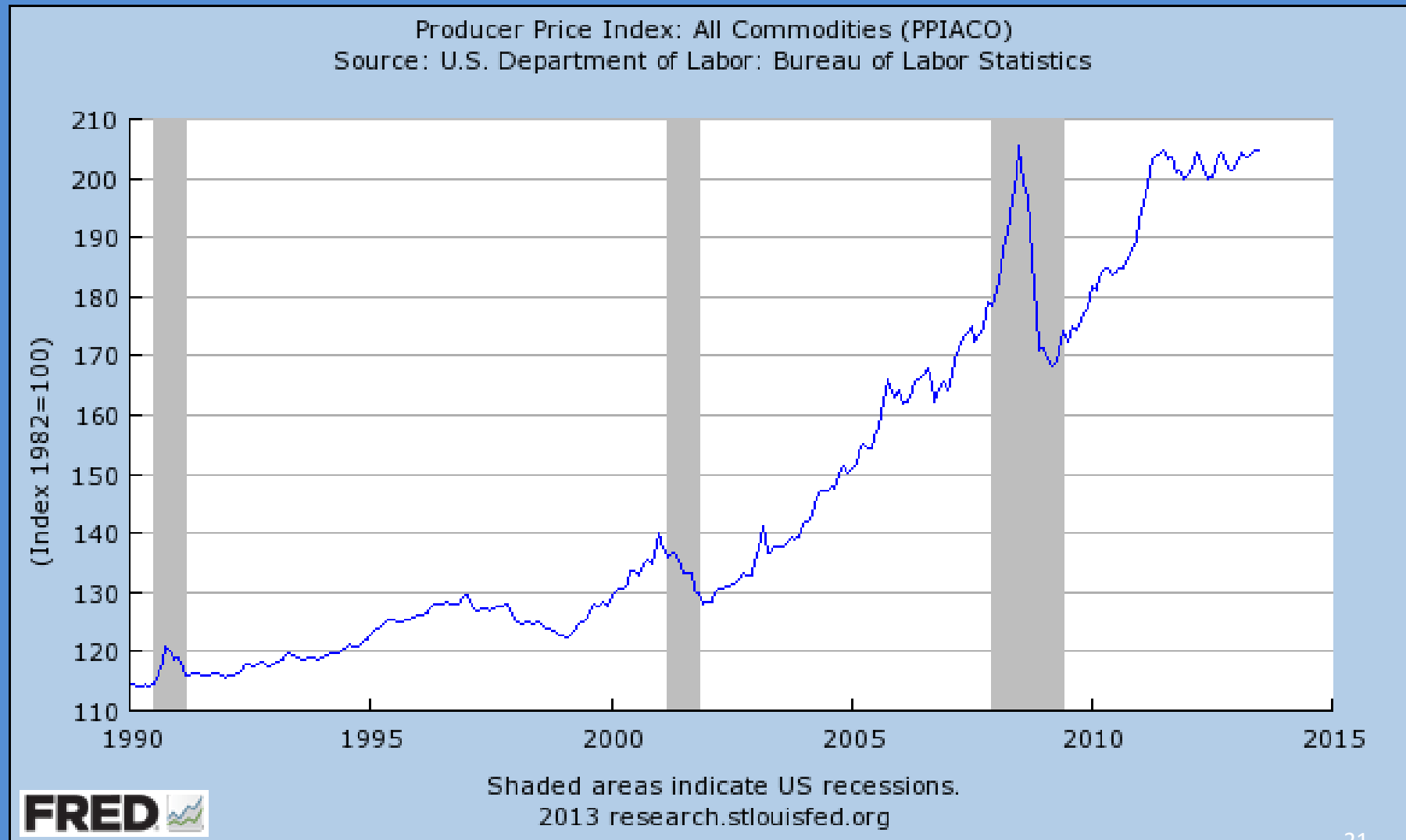
Recently, inflation has been well-behaved



... with ample labor, unit labor costs are also well-behaved ...

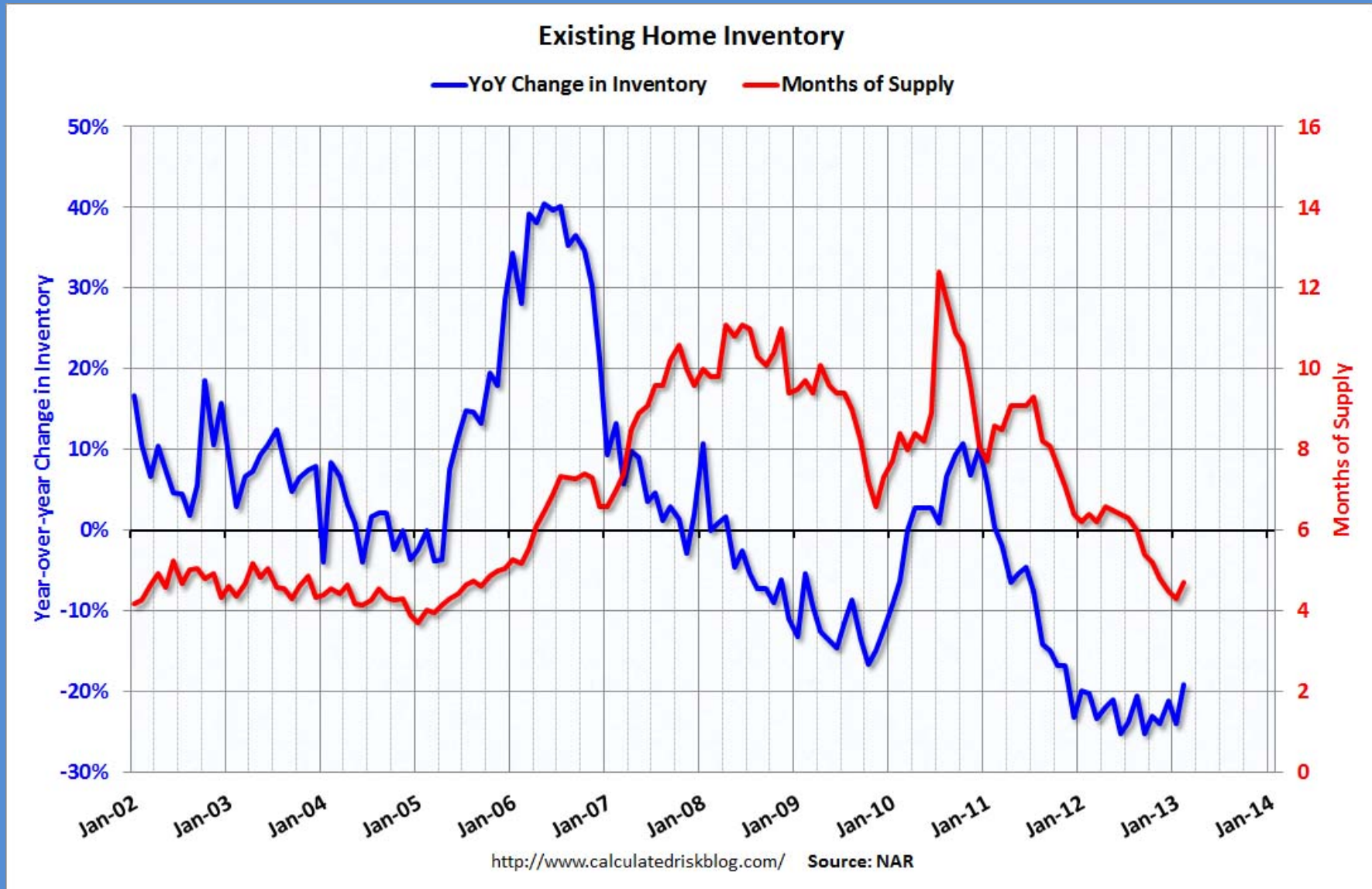


... and commodity prices appear to be stable, which should keep inflation in check.

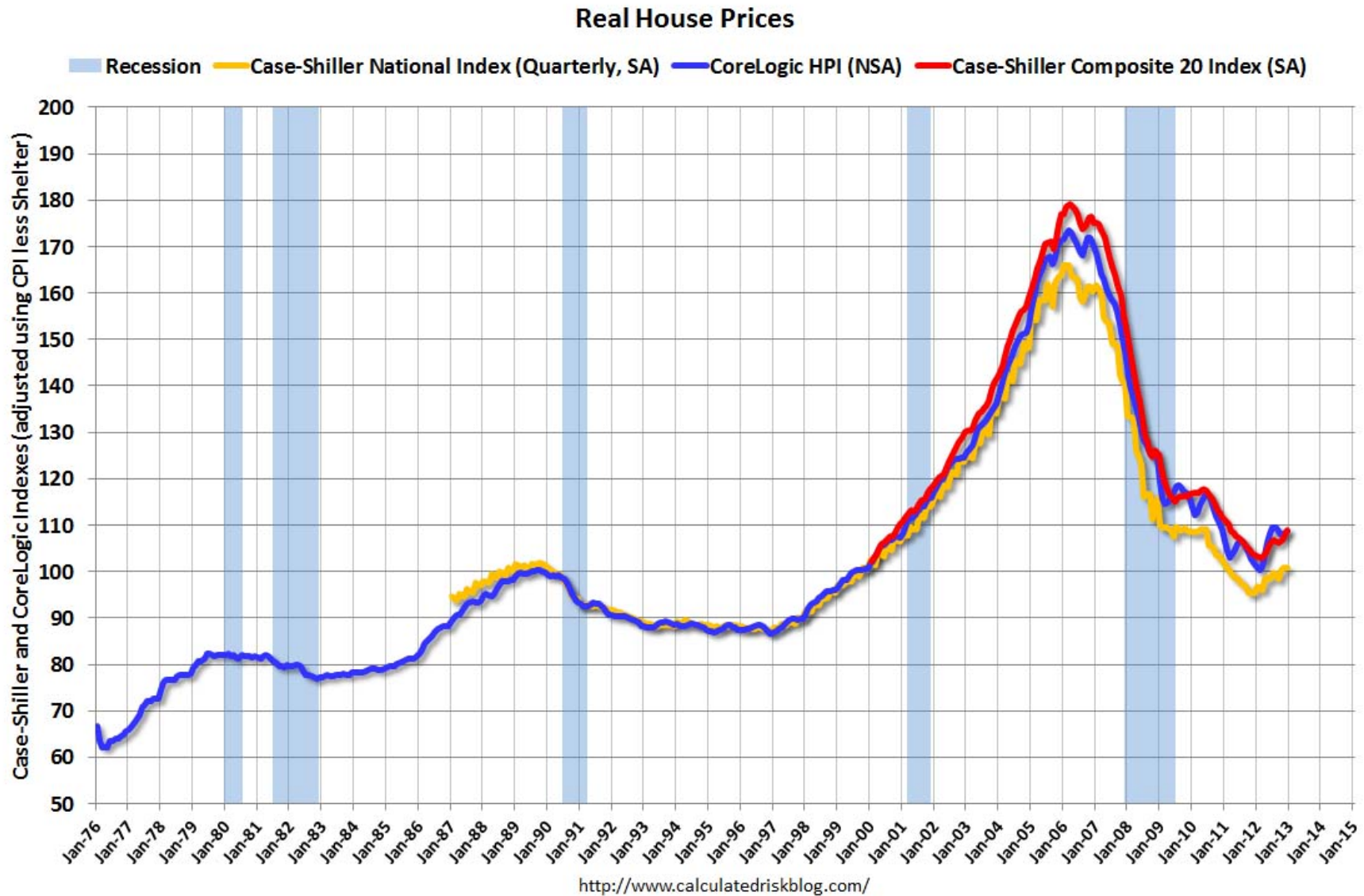


Housing

Existing home inventories are low and shrinking.



Real house prices bottomed out in 2012



Wisconsin homes sold and median prices up, but lagging national price statistics

Wisconsin home sales, prices in July

Sales of existing homes rose in every region of Wisconsin in July.

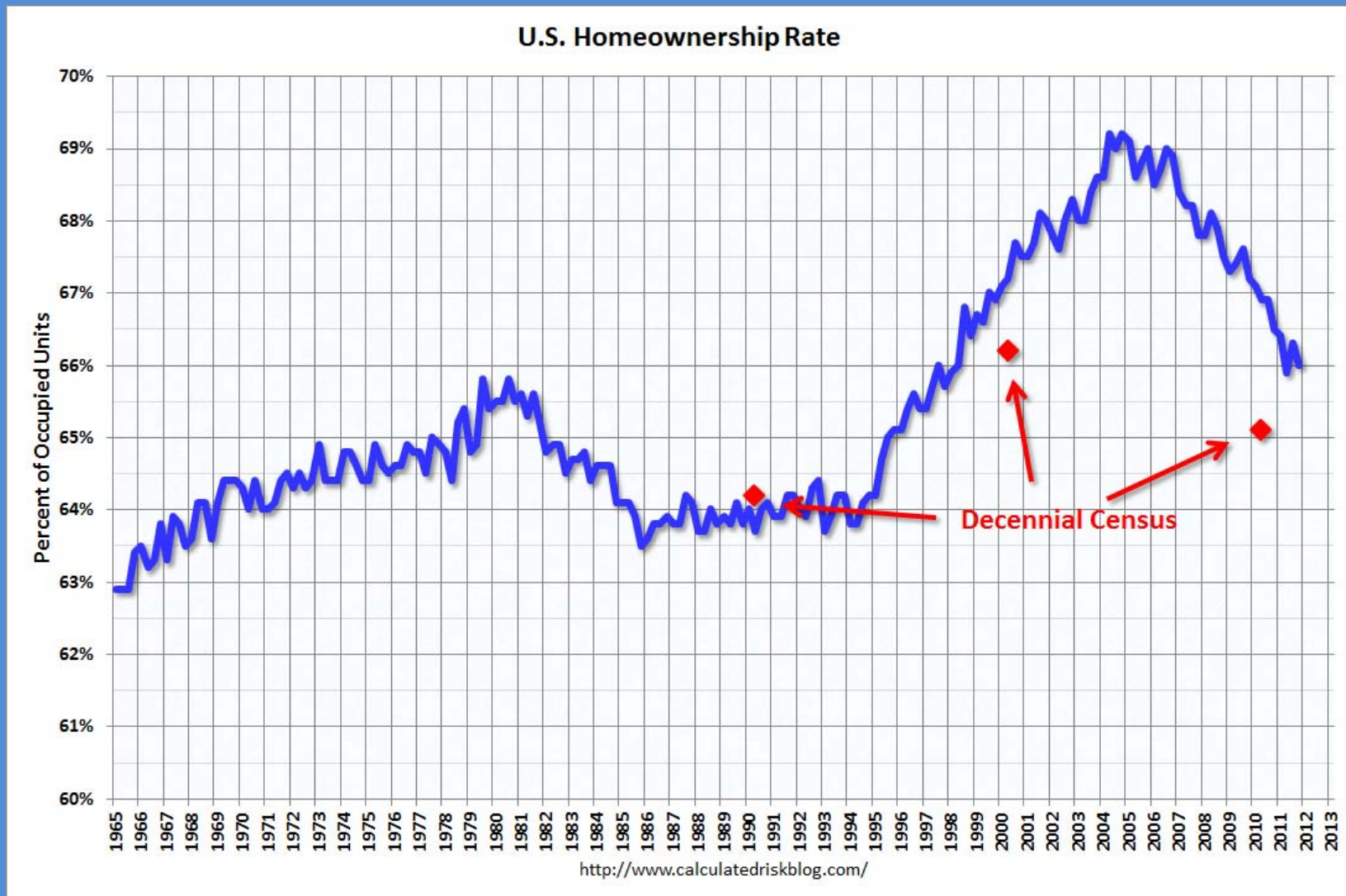
REGION	HOMES SOLD		% CHANGE	MEDIAN PRICE		% CHANGE
	2012	2013		2012	2013	
Southeast	2,241	2,711	+21.0	\$154,000	\$165,000	+7.1
South central	1,362	1,626	+19.4	\$165,000	\$180,000	+9.1
West	605	761	+25.8	\$140,000	\$151,400	+8.1
Northeast	1,070	1,141	+6.6	\$123,600	\$131,000	+6.0
Central	369	413	+11.9	\$110,000	\$117,400	+6.7
North	548	609	+11.1	\$130,000	\$130,000	0.0

Note: Region totals don't match state totals.

Source: Wisconsin Realtors Association

Journal Sentinel

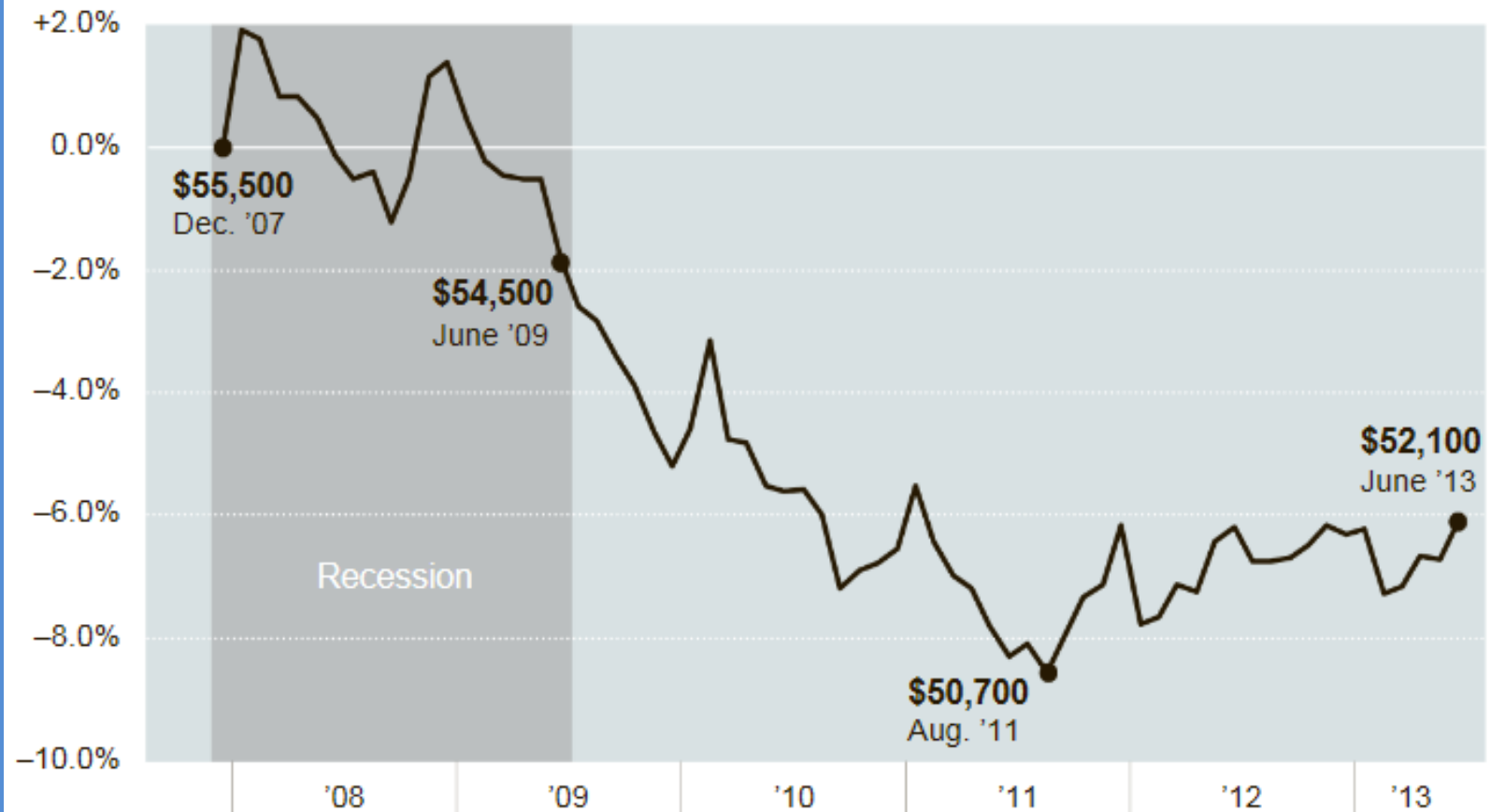
U.S. homeownership reverts to the historic mean.



Real Median Household Income

Change in median household income

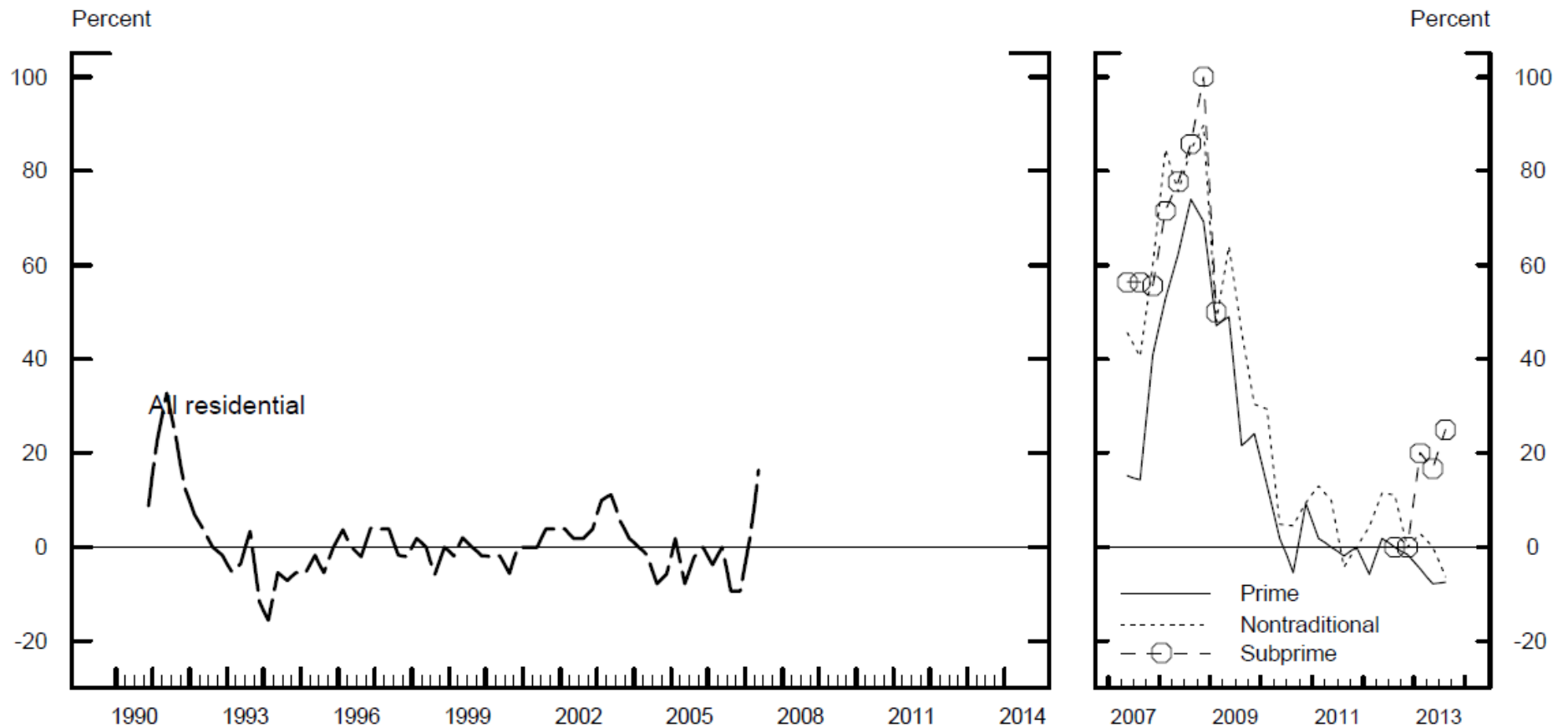
Since the start of the recession



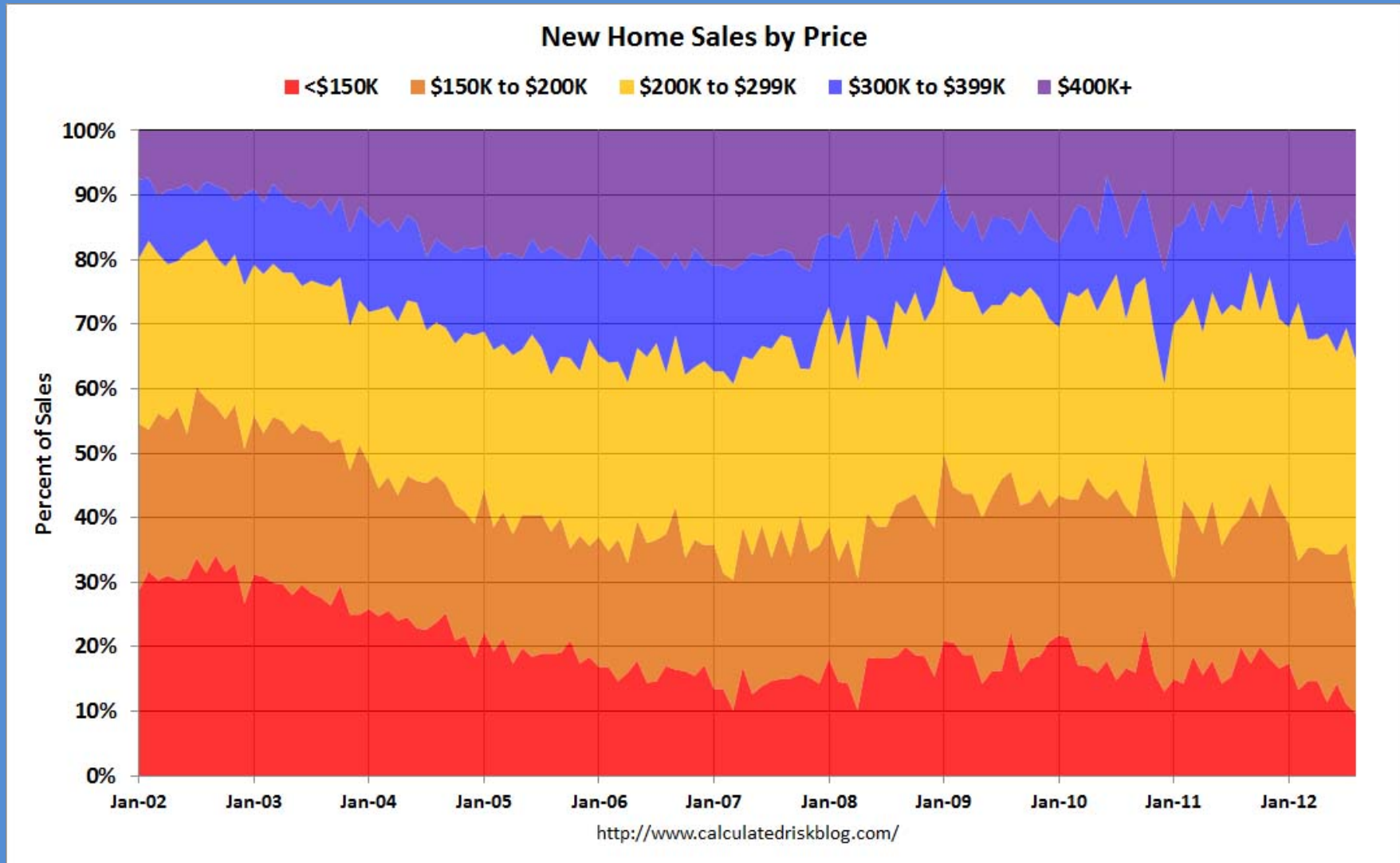
Source: NYT, August 21, 2013.

Freddie and Fannie continue to maintain tight underwriting standards for mortgage loans

Net Percentage of Domestic Respondents Tightening Standards for Residential Mortgage Loans

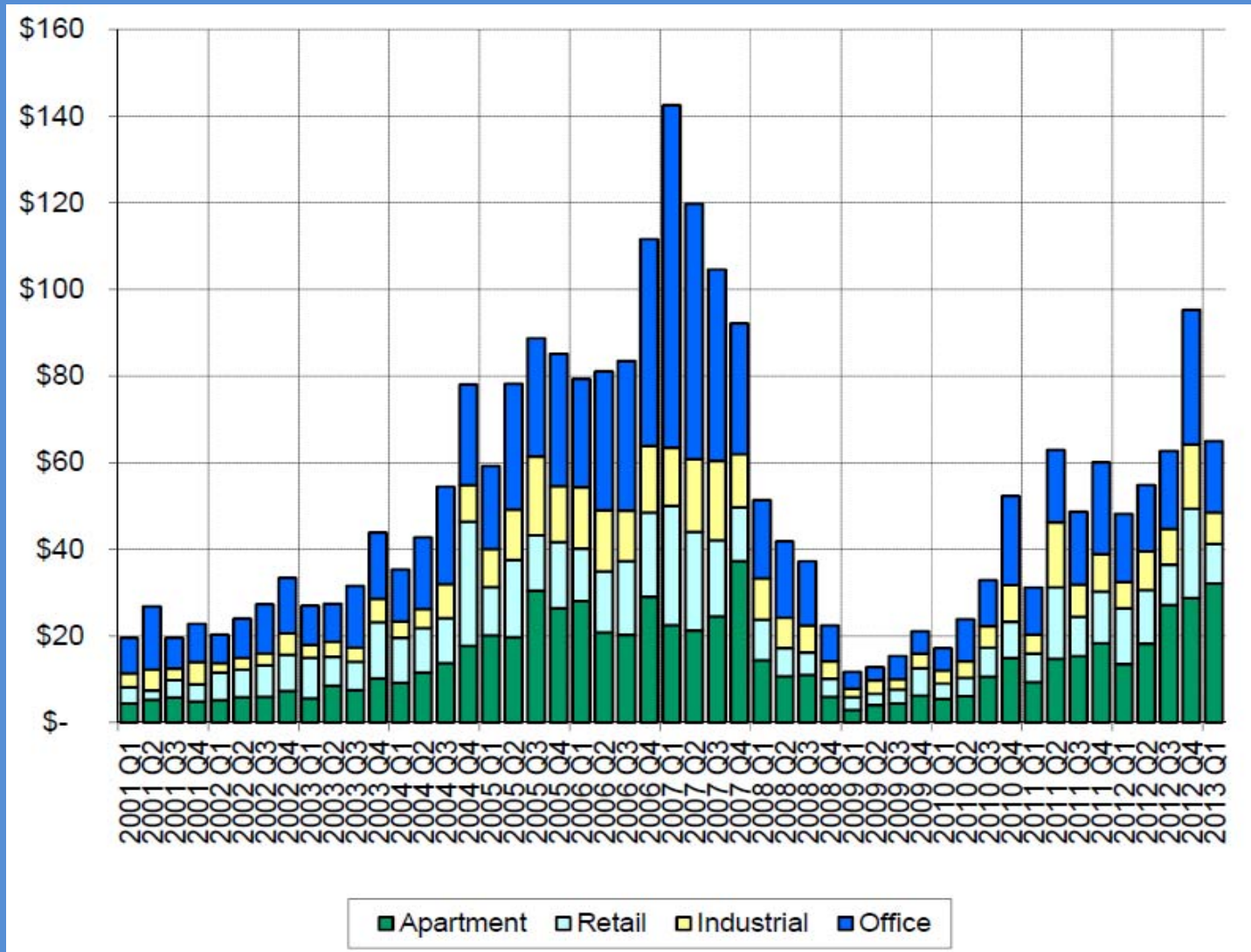


Keeping first-time homebuyers out of the market



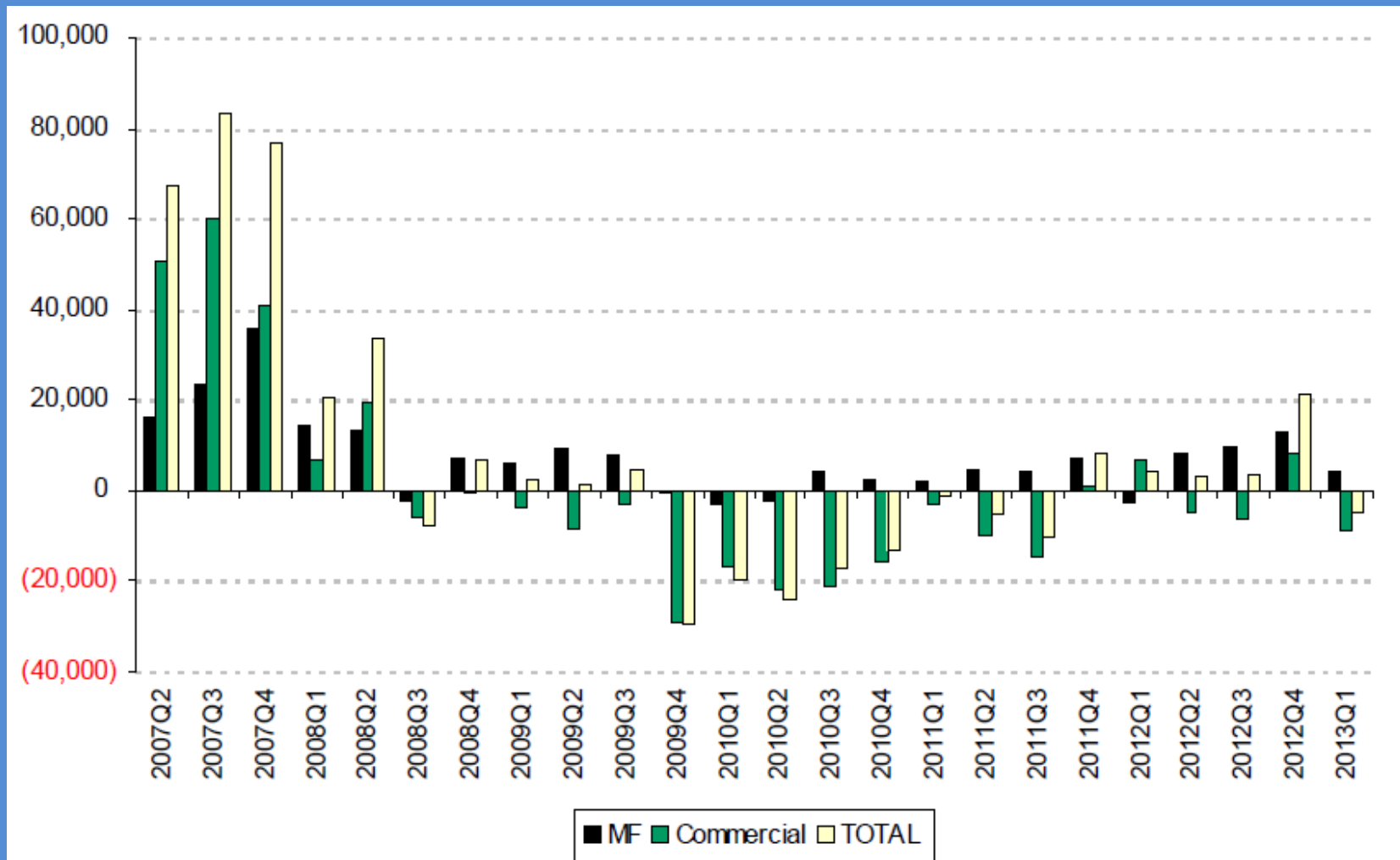
Commercial Real Estate

It appears as if commercial real estate transaction volume is back, what do you see?



The commercial real estate debt markets remain tepid for non-multifamily product

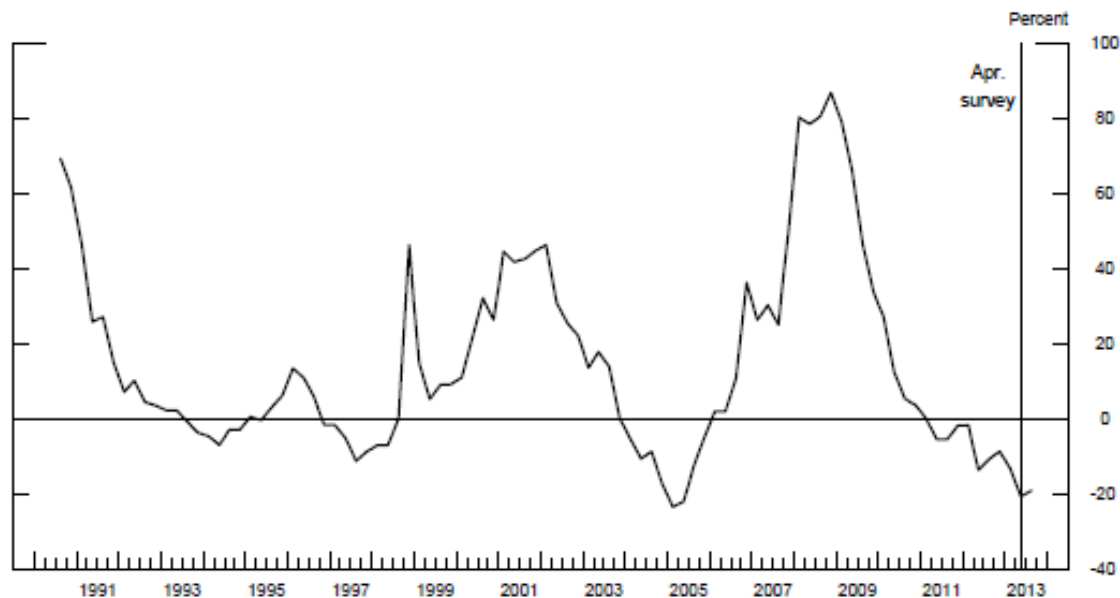
Net Change in Commercial Real Estate Debt Outstanding (in millions)



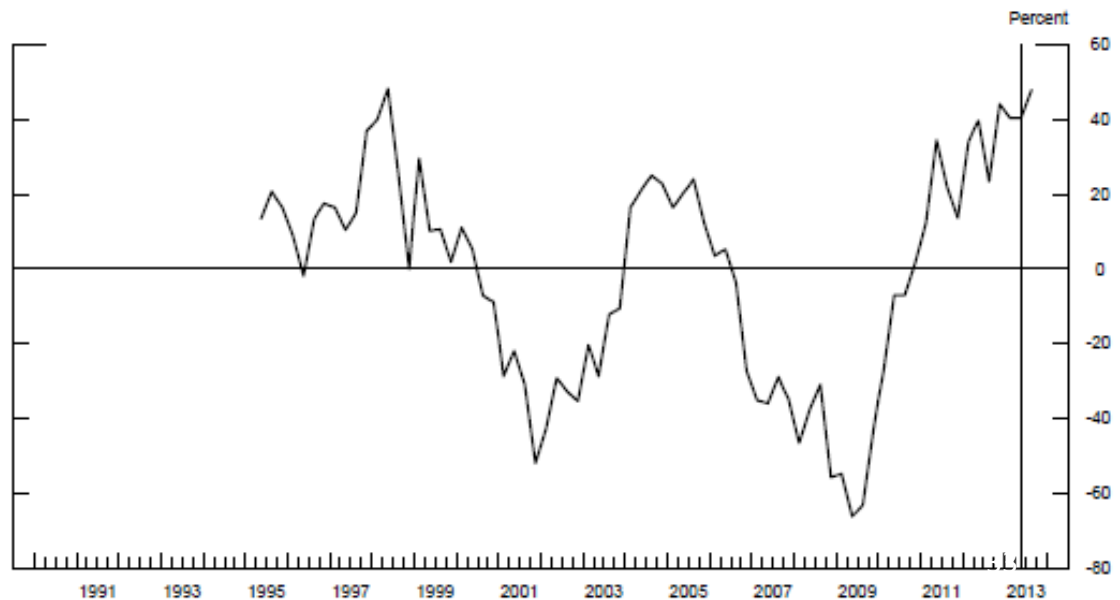
Banks are easing standards and commercial real estate loan demand is growing

Source: Federal Reserve Flow of Funds.

Net Percentage of Domestic Respondents Tightening Standards for Commercial Real Estate Loans



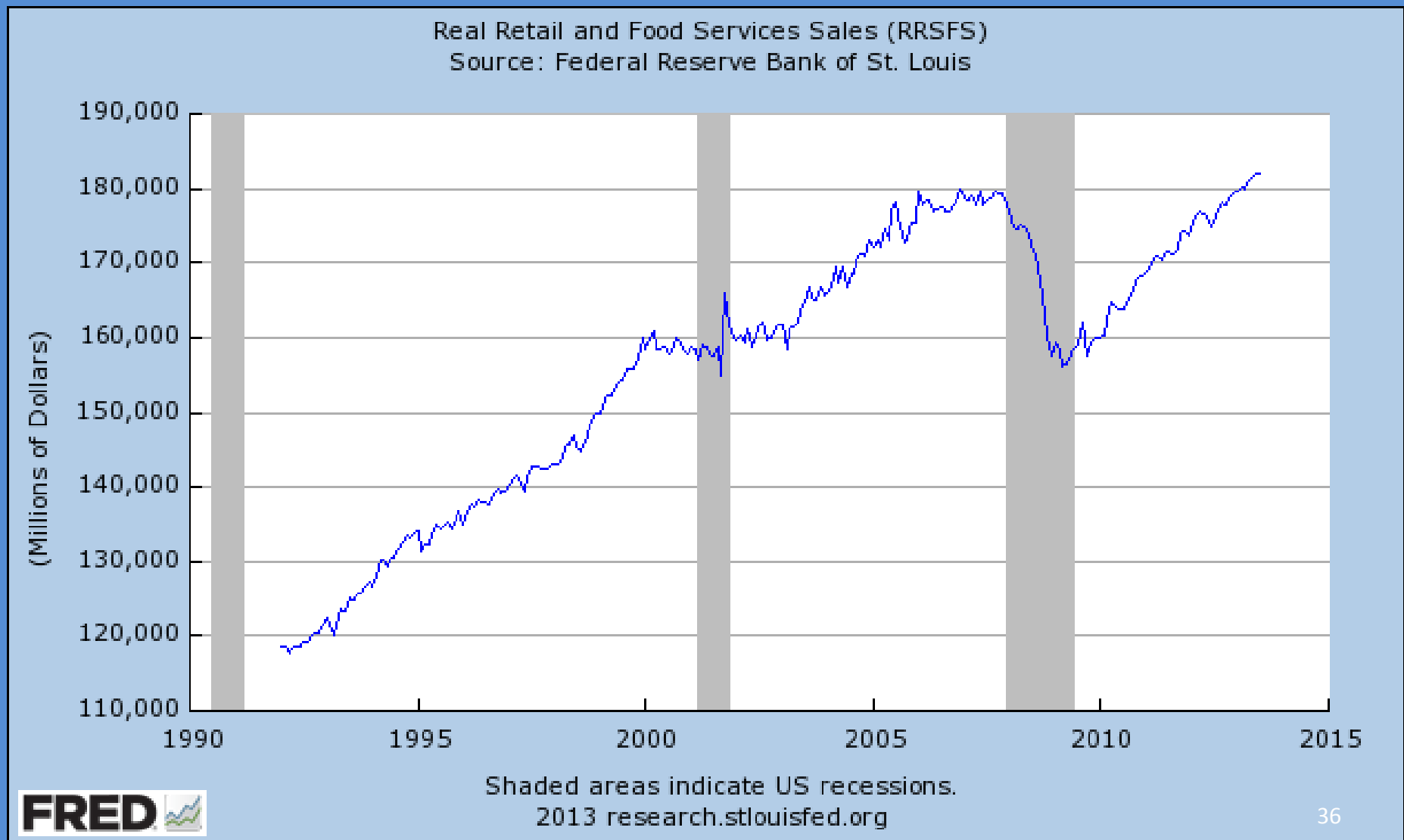
Net Percentage of Domestic Respondents Reporting Stronger Demand for Commercial Real Estate Loans



Property Markets

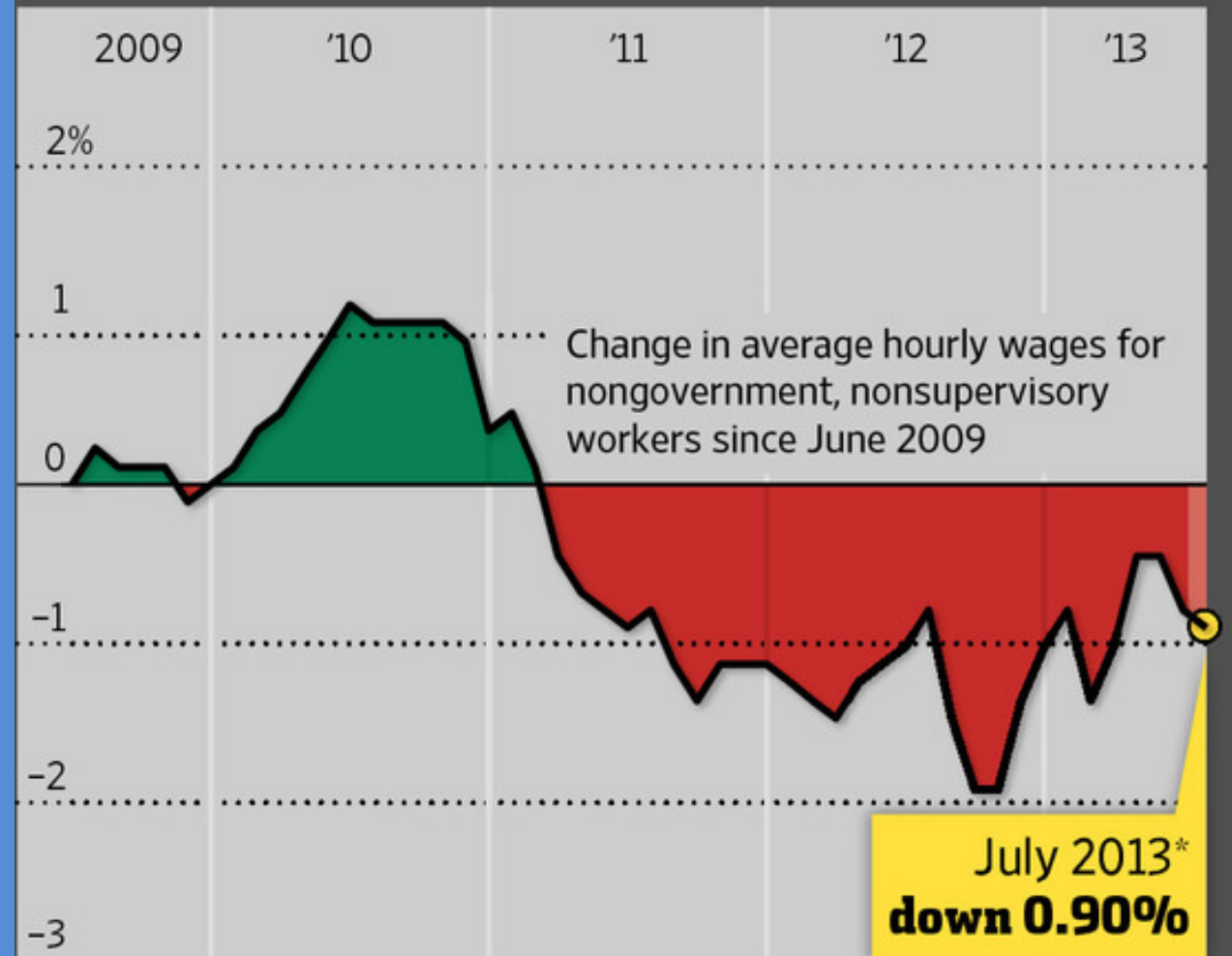
Retail

Real retail sales fundamentals are solid but the consumer has headwinds with payroll and affordable healthcare taxes with new limits on unemployment benefit



Real average wage increases have fallen and most all wage growth is concentrated in upper income levels

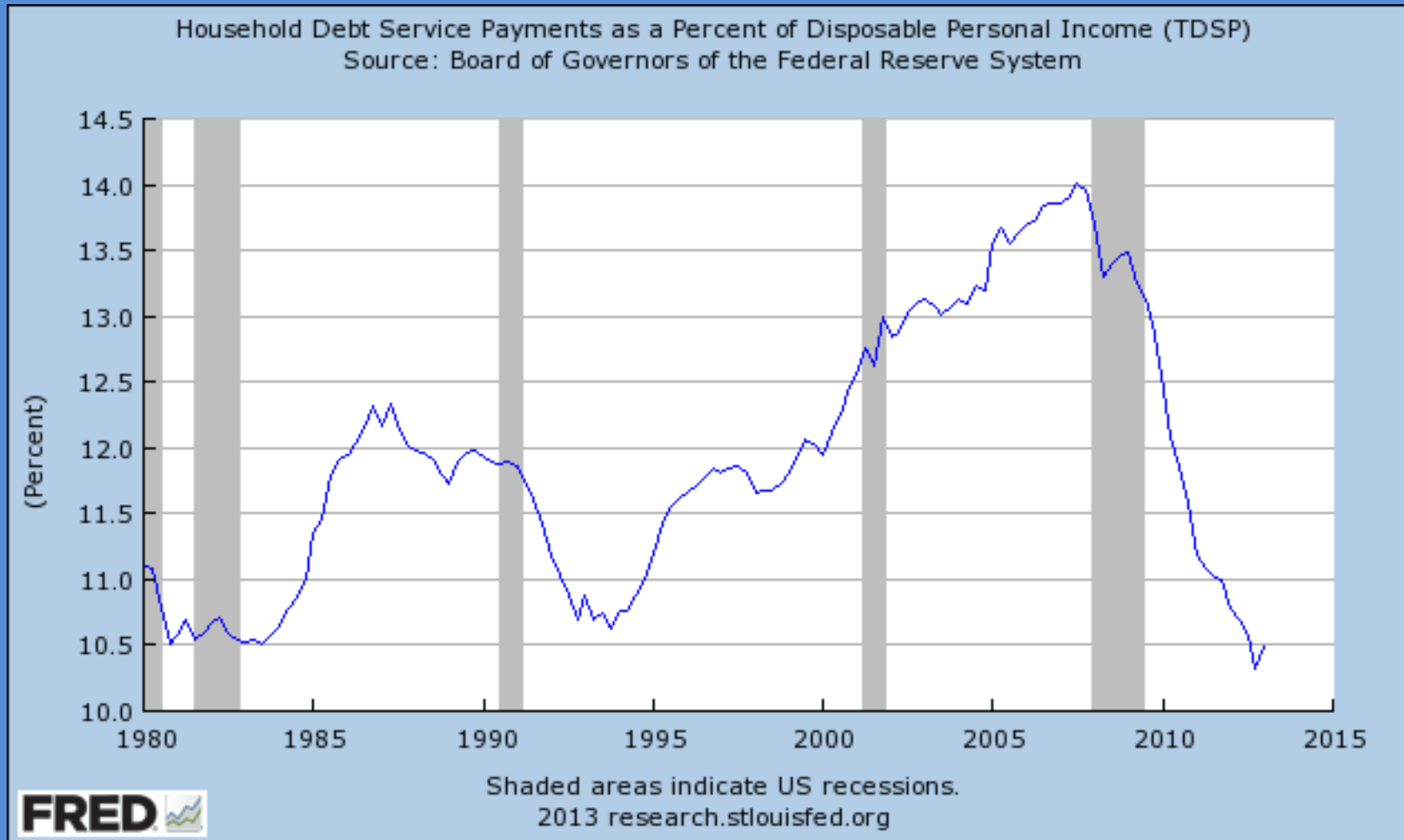
Average wages for many U.S. workers, adjusted for inflation, have fallen since the end of the recession.



*June and July data are preliminary Source: Labor Department

The Wall Street Journal

Household debt service levels provide dry spending powder

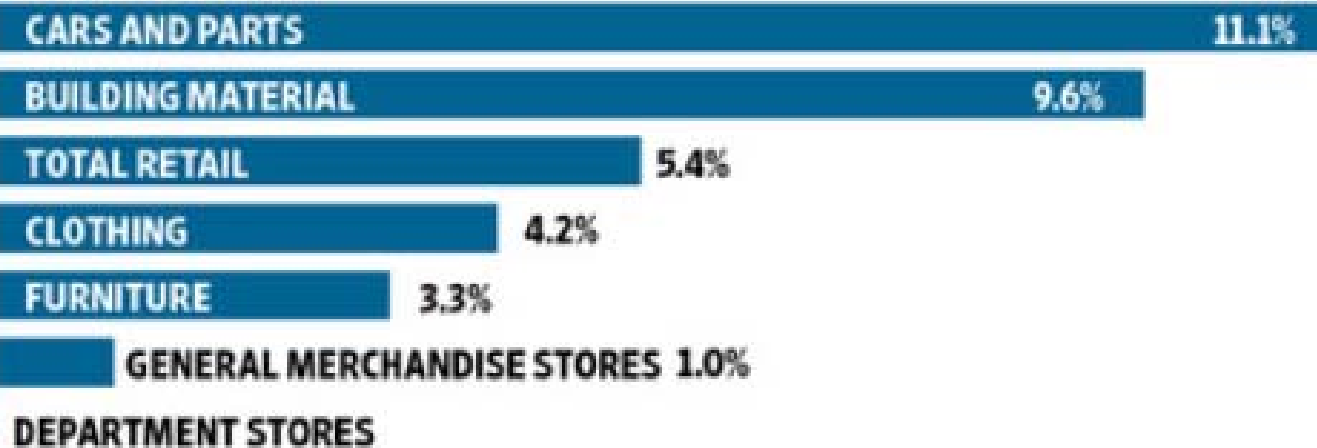


Spending has shifted to durable goods, which signals consumer confidence

Spending Habits

Year-over-year change in U.S. retail sales from May through July by category

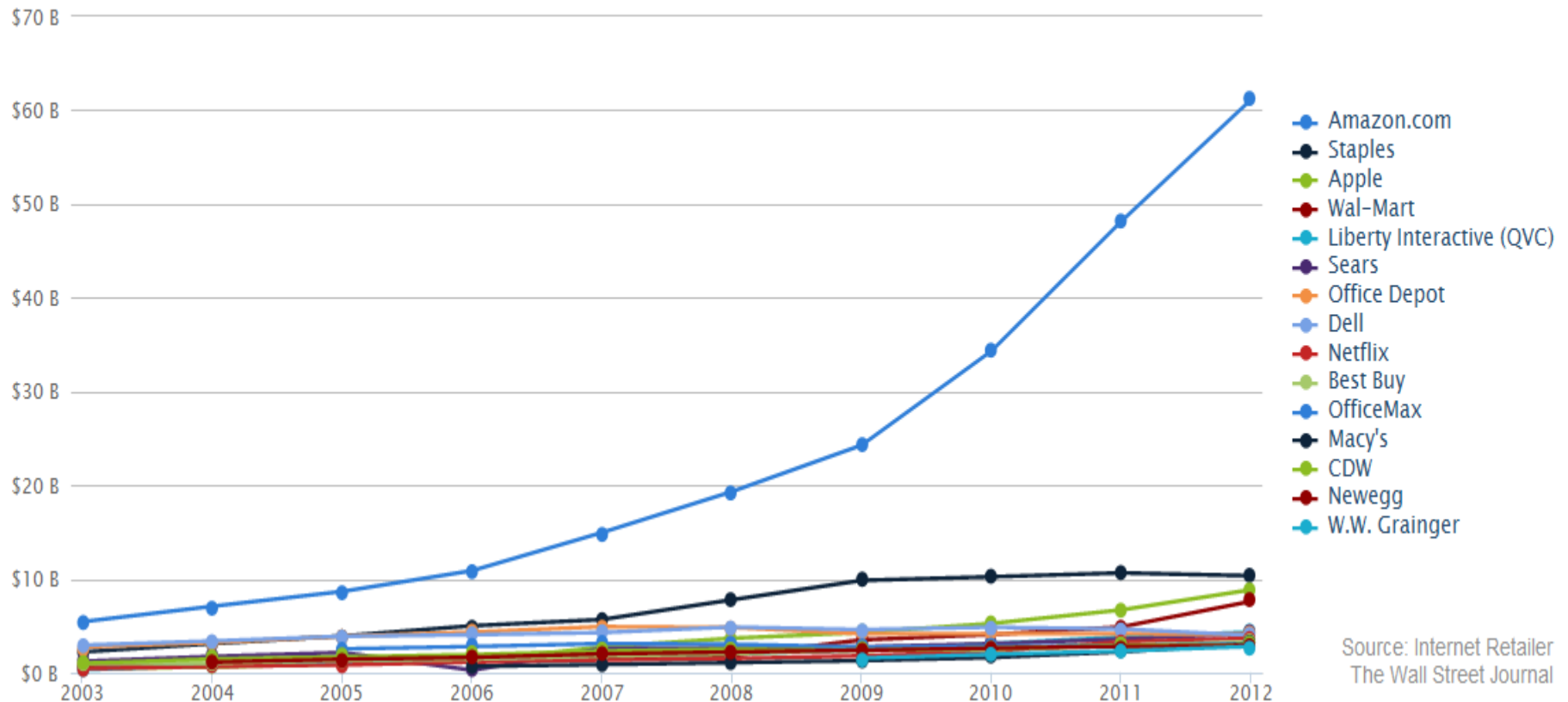
-4.8%



Multi-channel retailing the new normal (internet sales for Walmart \$7.7B/\$473B and for Best Buy \$3.3B/\$48B)

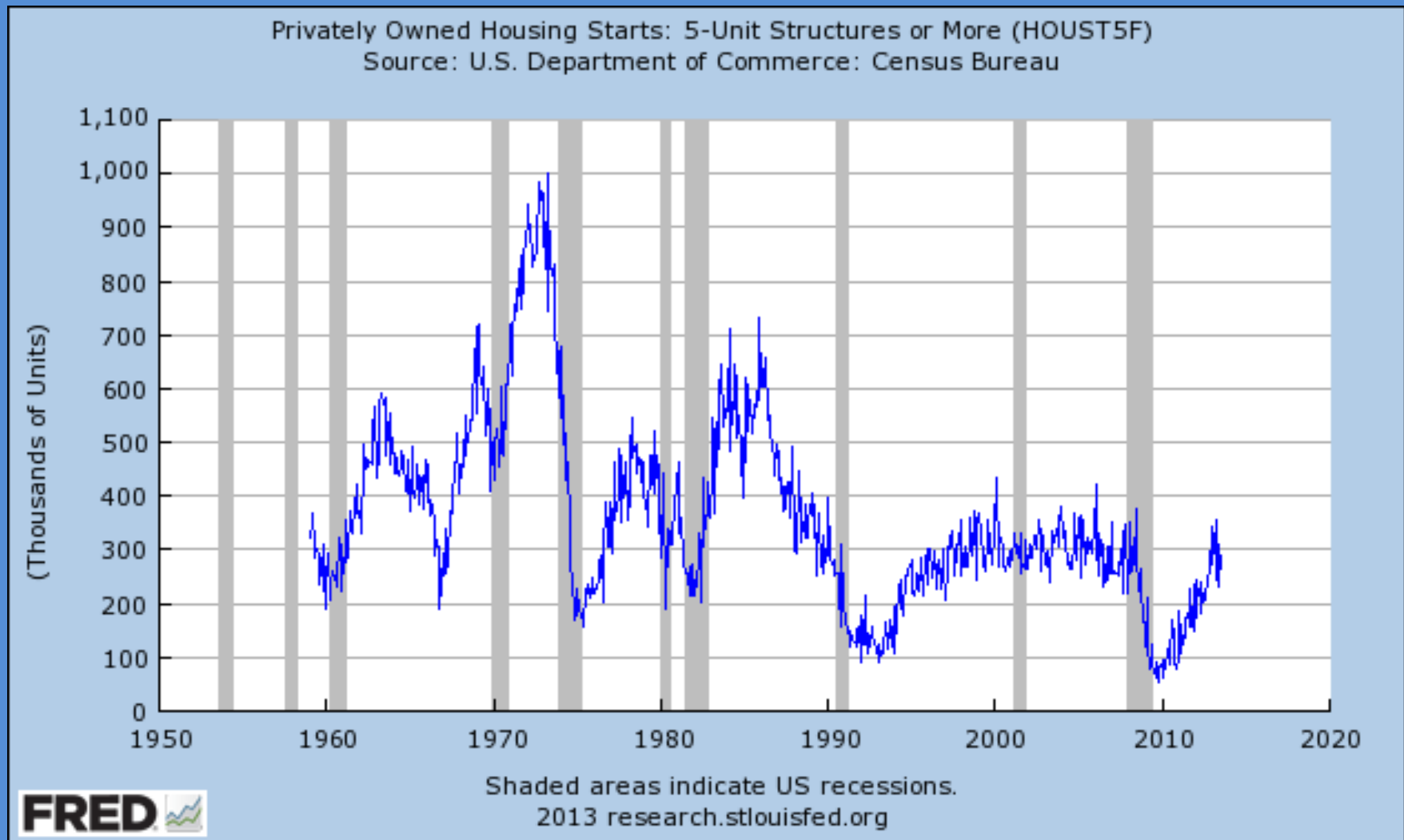
Running Away

Amazon has significantly outgrown the next 14 largest Internet retailers over the past decade. **Select the companies to hide and compare sales results.**



Apartments

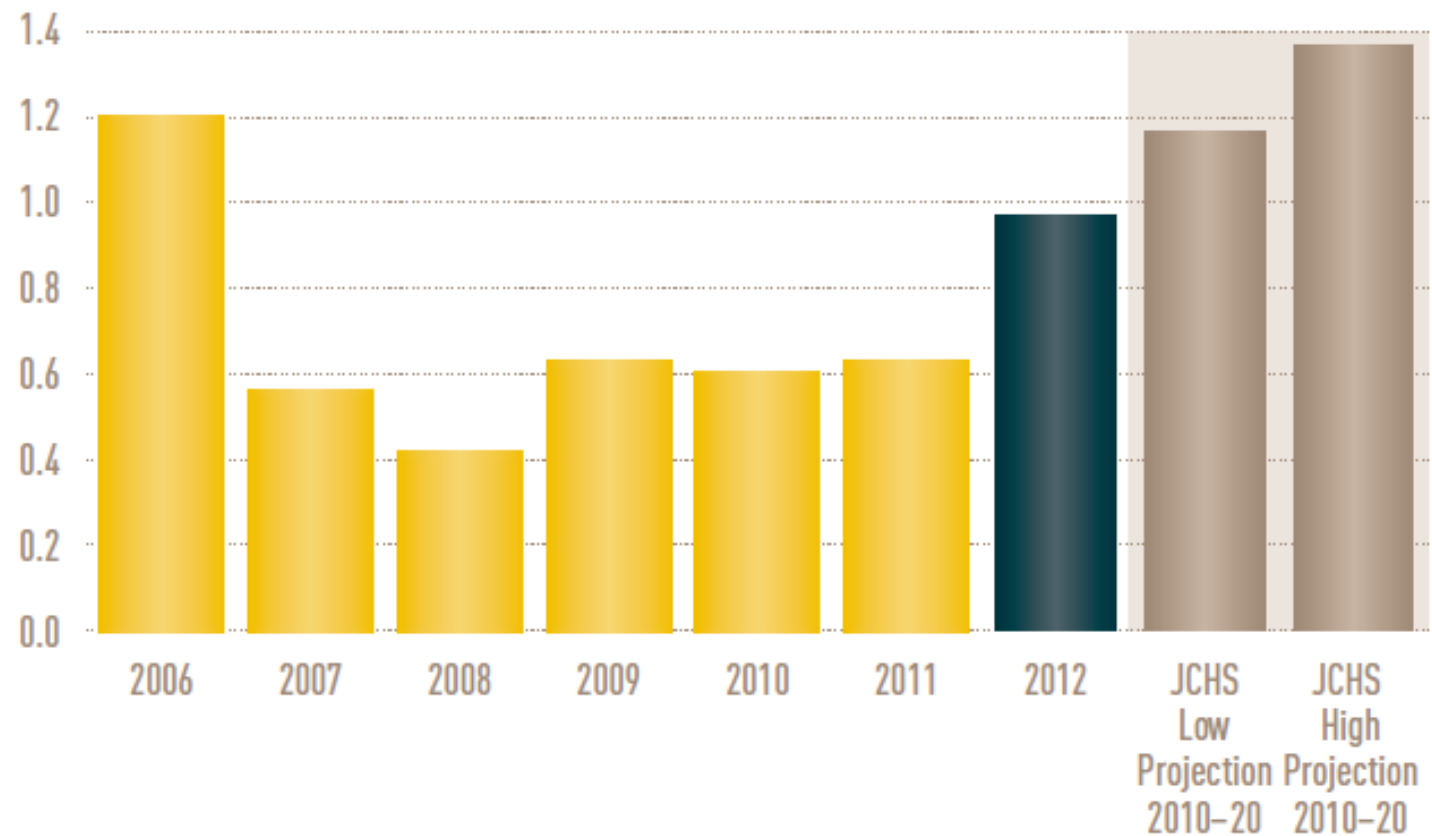
Multifamily starts averaged 360,000 since 1956,
in July 2013 there were 290,000 starts



Pent-up household growth not yet tapped

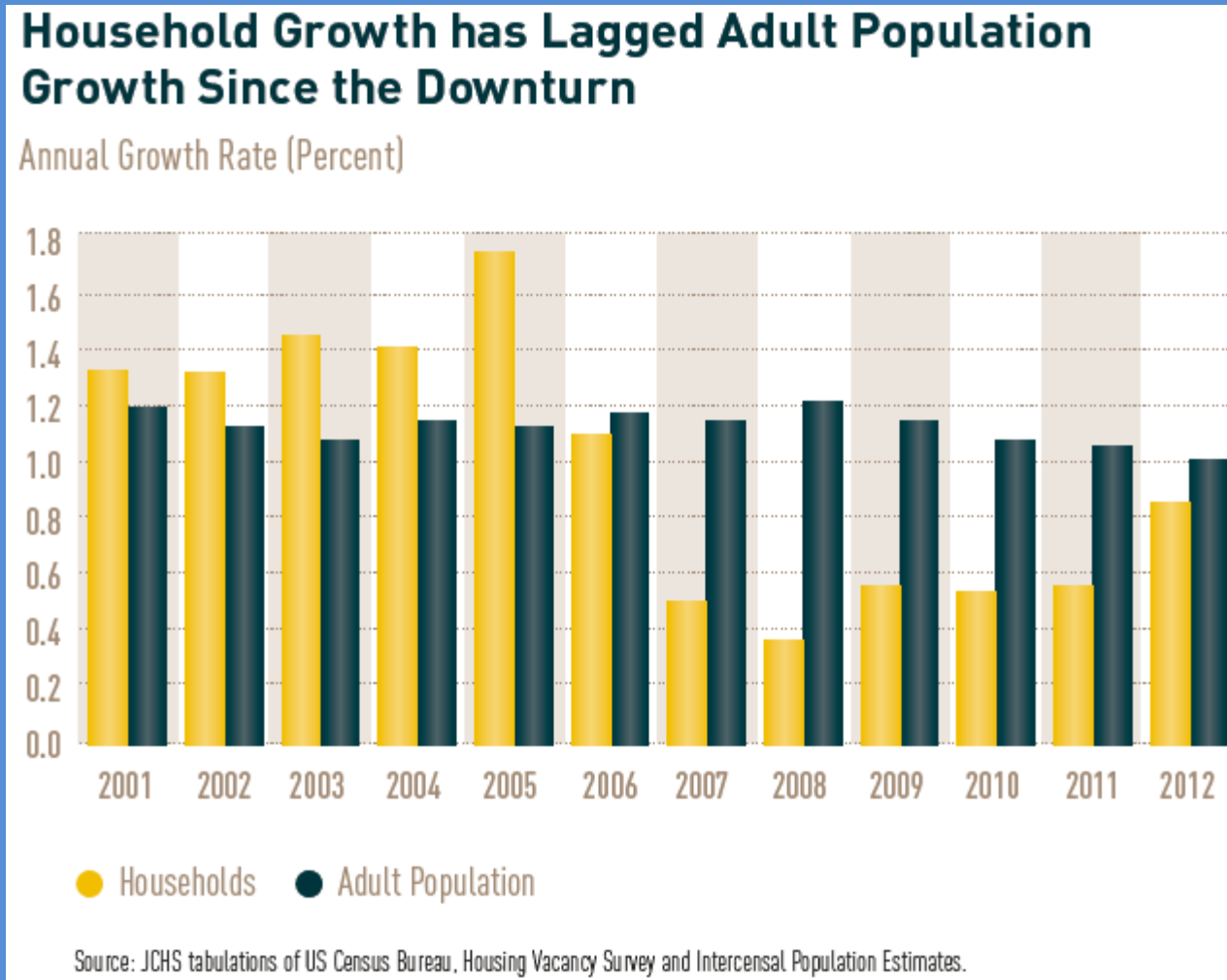
Household Growth Approached the One Million Mark in 2012

Change in Households (Millions)



Source: Joint Center for Housing Studies, State of the Nation's Housing: 2013.

Another look at pent up household demand

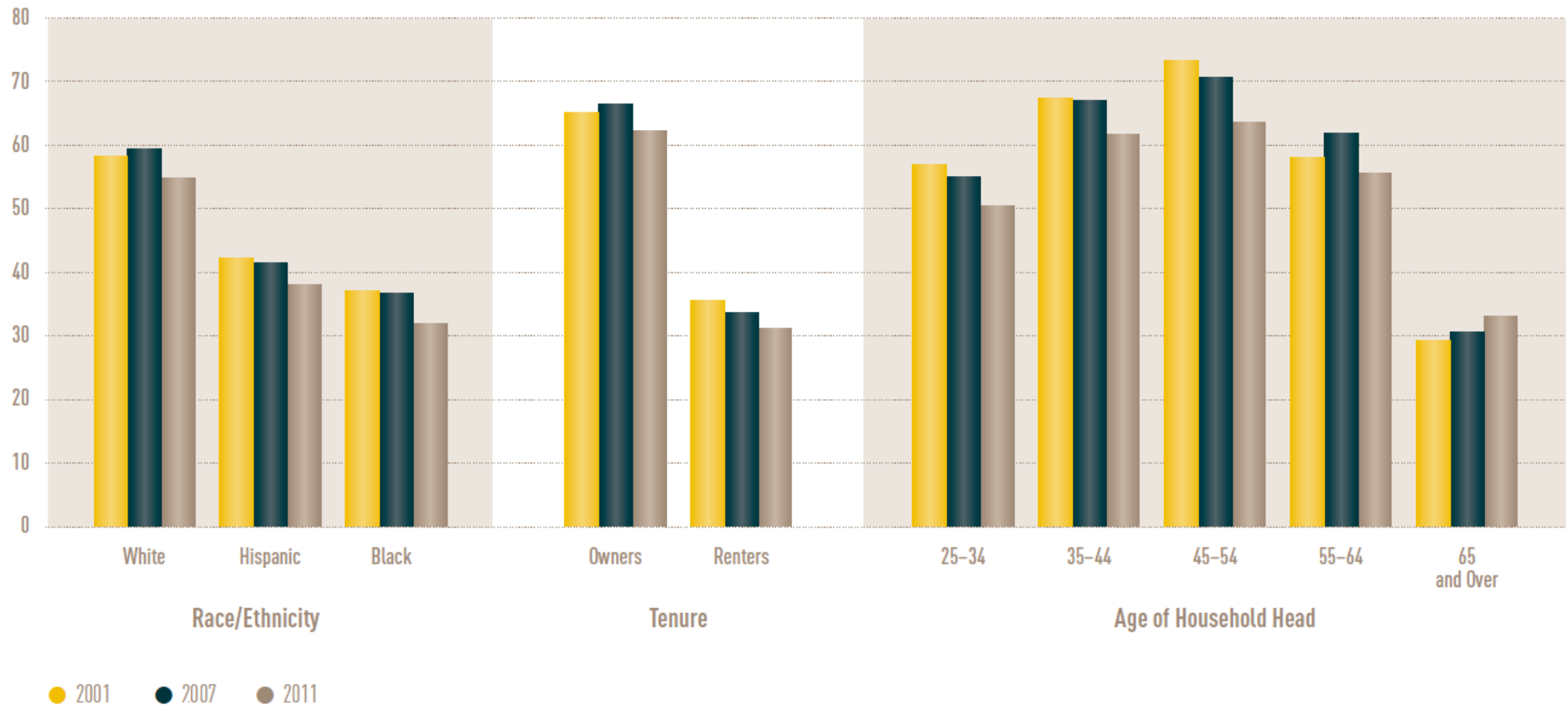


Source: Joint Center for Housing Studies, State of the Nation's Housing: 2013.

Lower real income growth generate greater renter demand

Most Types of Households Have Seen Their Real Incomes Decline over the Past Decade

Median Household Income (Thousands of 2011 dollars)

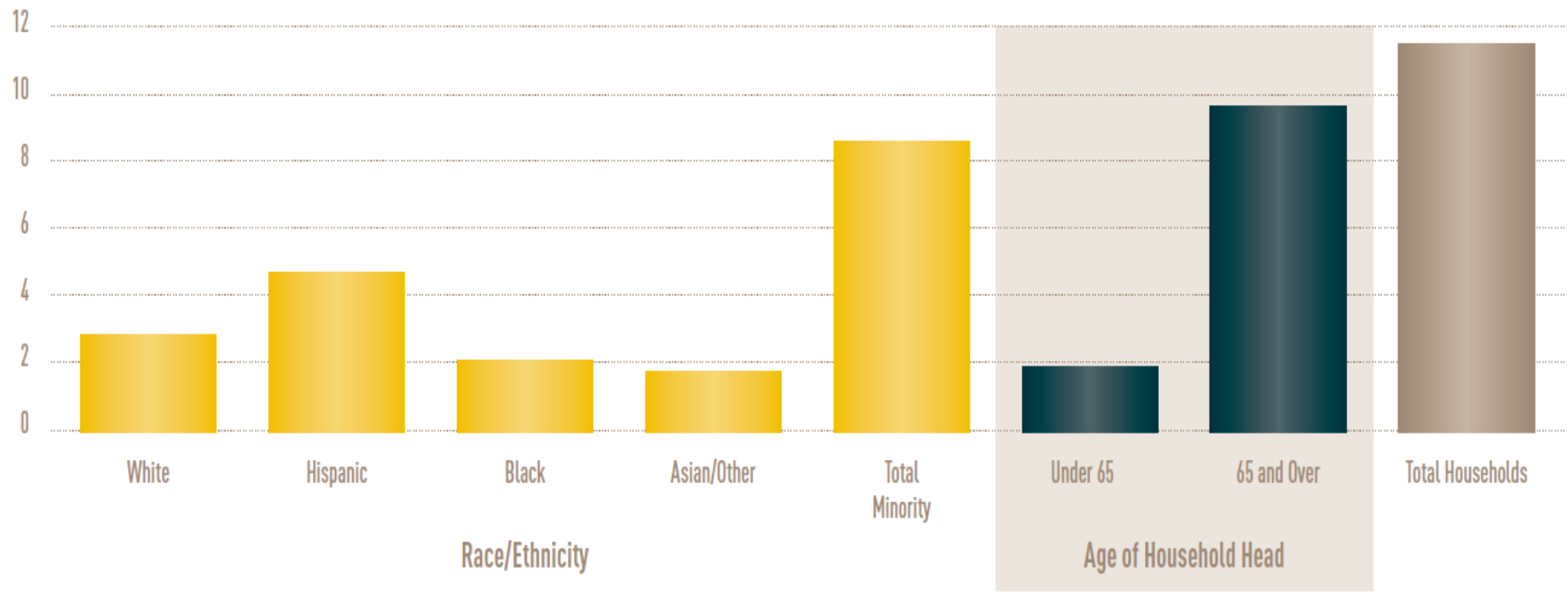


Source: Joint Center for Housing Studies, State of the Nation's Housing, 2013.

Minorities and seniors will drive most all household growth in the coming decade

Minorities and Seniors Will Drive Household Growth Over the Next Decade

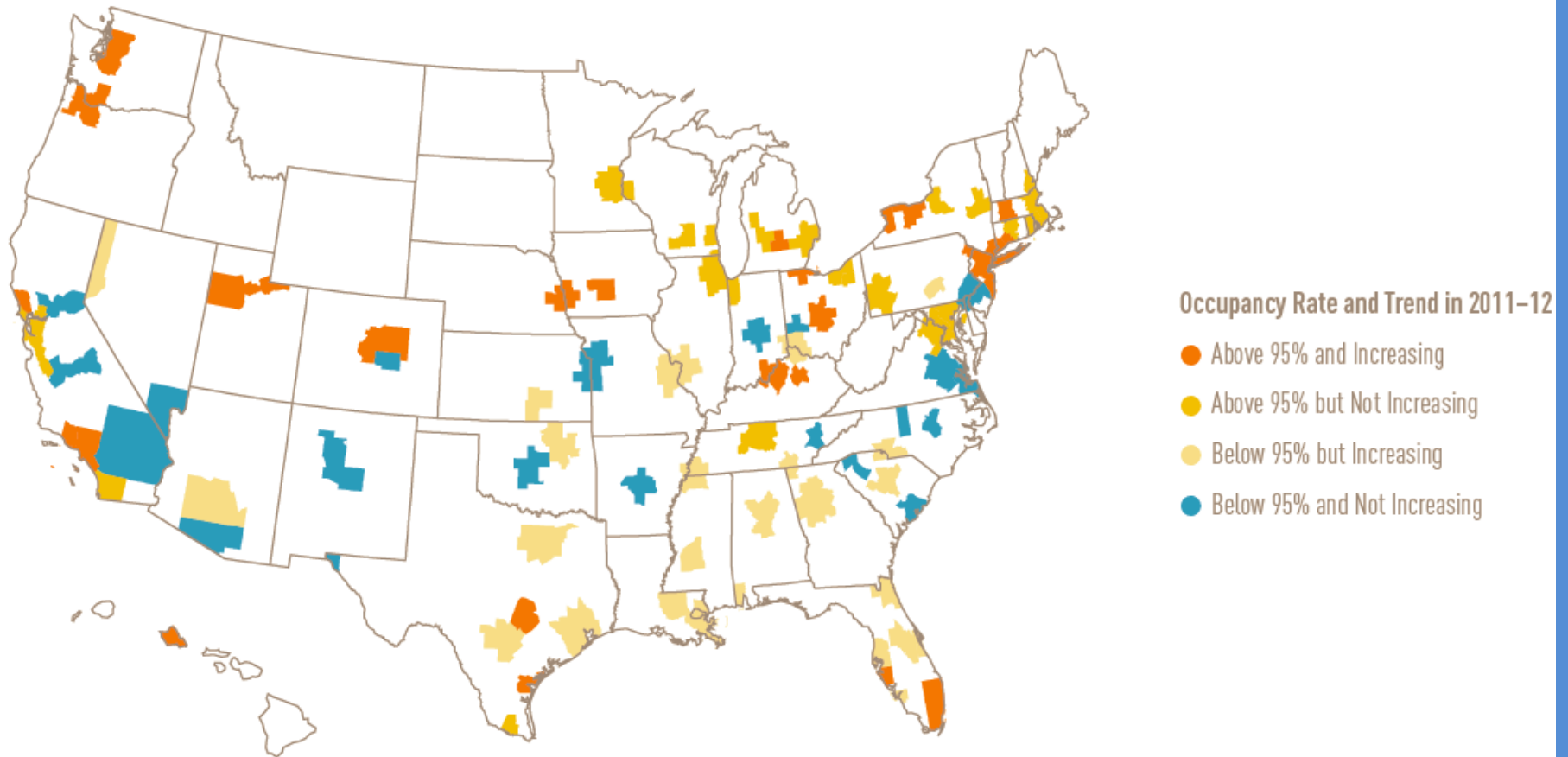
Projected Household Growth, 2013–23 (Millions)



Source: Joint Center for Housing Studies, State of the Nation's Housing: 2013.

Midwest has among the best multifamily occupancy rates

Rental Markets in Most Large Metro Areas Are Tight or Tightening

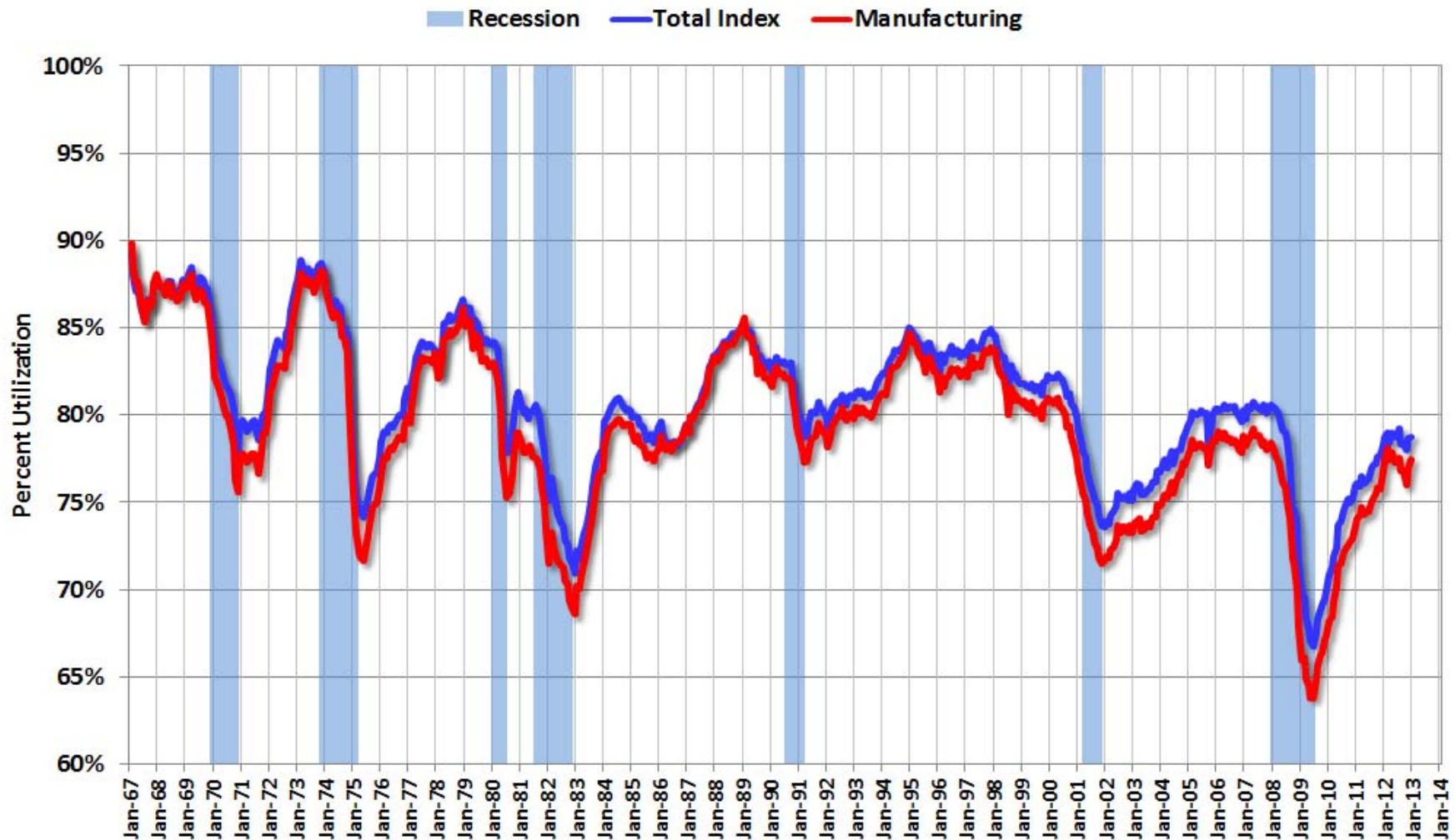


Source: *State of the Nation's Housing Market, 2013*, Joint Center for Housing Studies of Harvard University.

Office and Industrial

Capacity utilization remains solid, which is comforting to industrial space owners

Capacity Utilization, Total Industry and Manufacturing

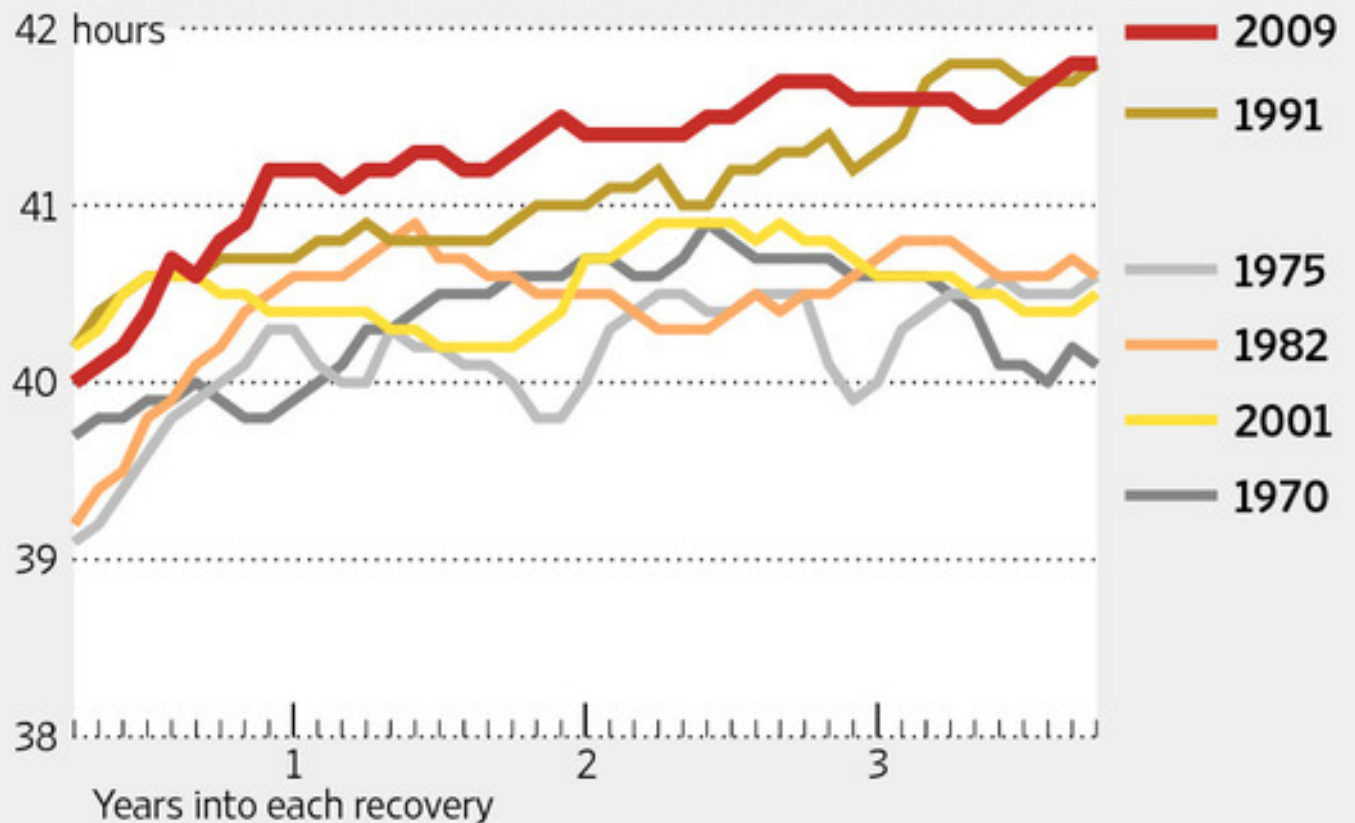


Source: Federal Reserve <http://www.calculatedriskblog.com/>

Manufacturing hours worked a solid signal for industrial markets

Longer Shifts

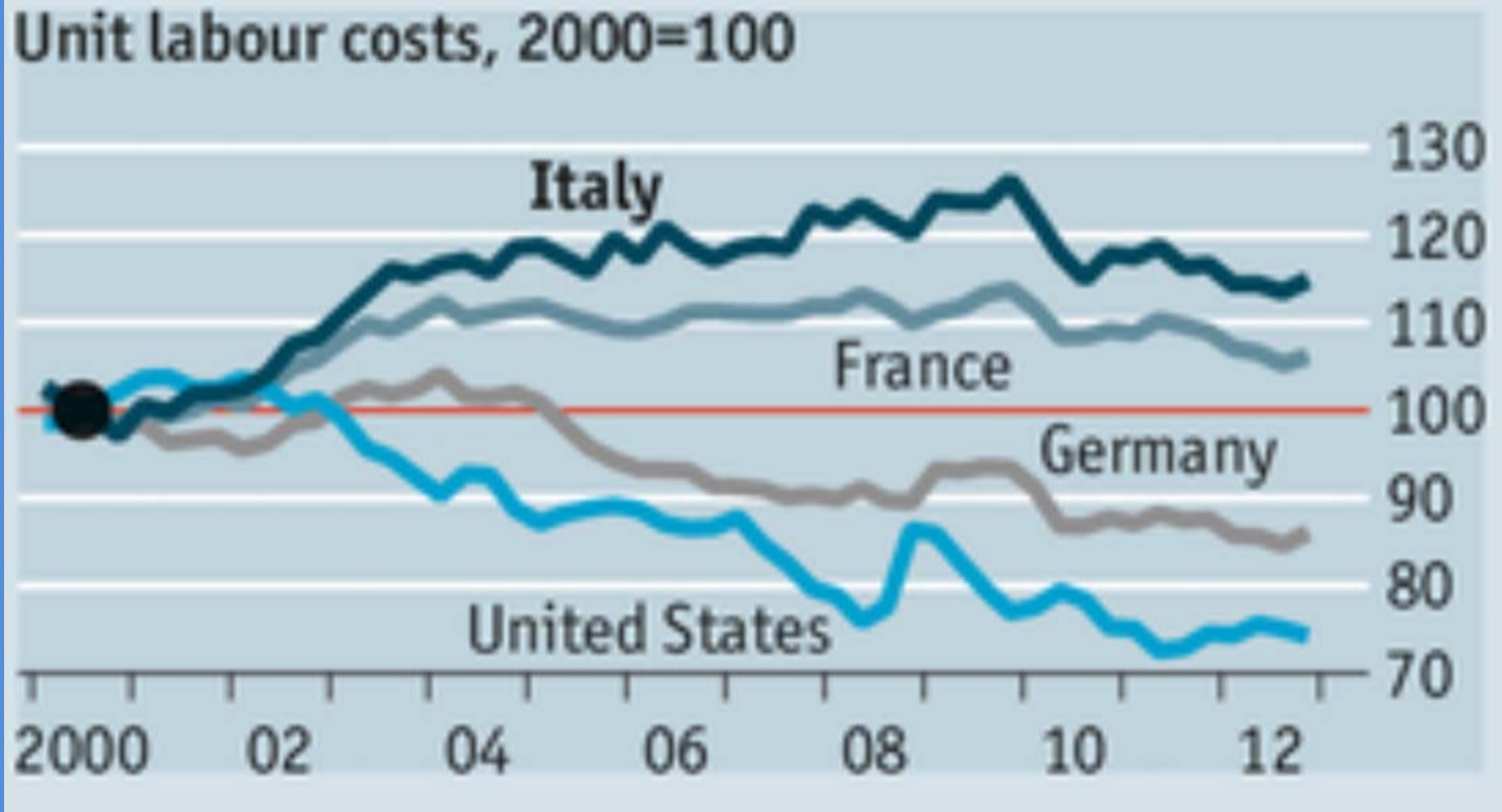
The number of hours worked by manufacturing employees has risen sharply in the current recovery. Average weekly hours of production and nonsupervisory employees*



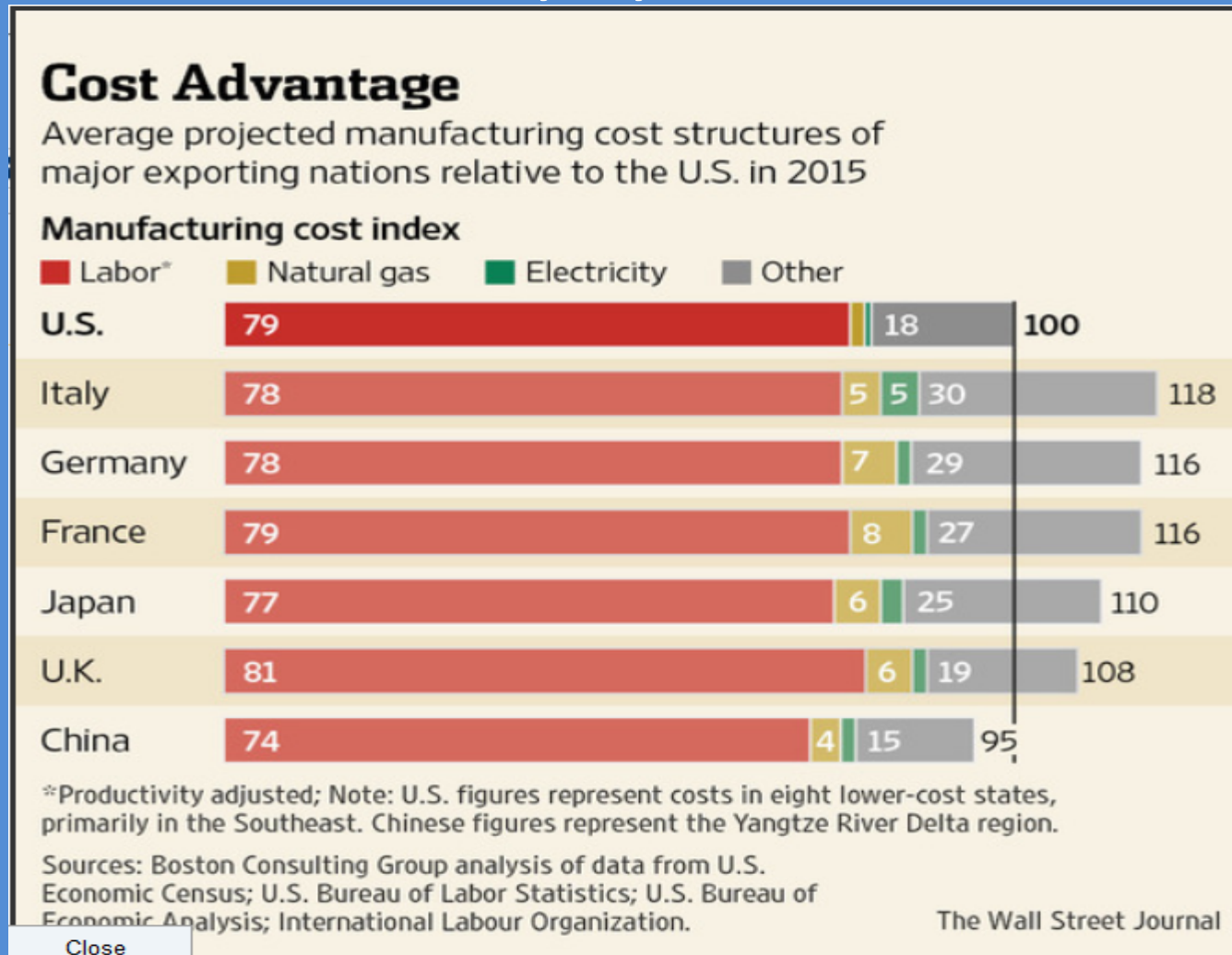
*Three-month moving averages Source: Labor Department

The Wall Street Journal

The U.S. labor continues to be highly competitive



Boston Consulting Group projects that U.S. Manufacturing increase by \$70-115 billion annually by the 2020

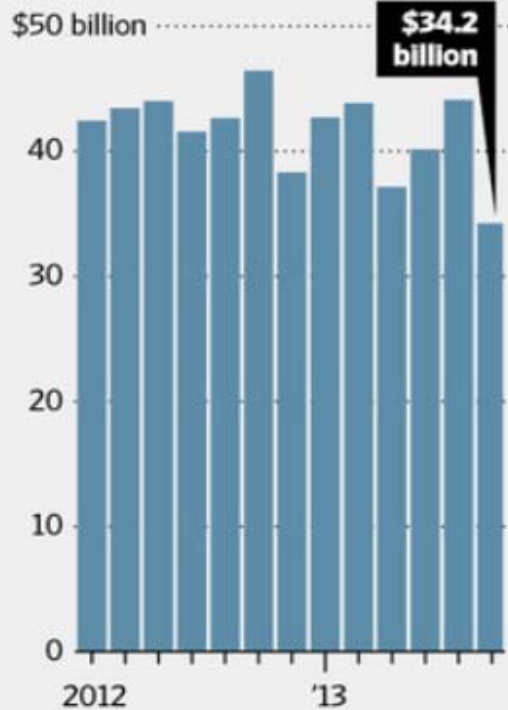


Oil boom shrinks trade deficit 22%

Looking Up

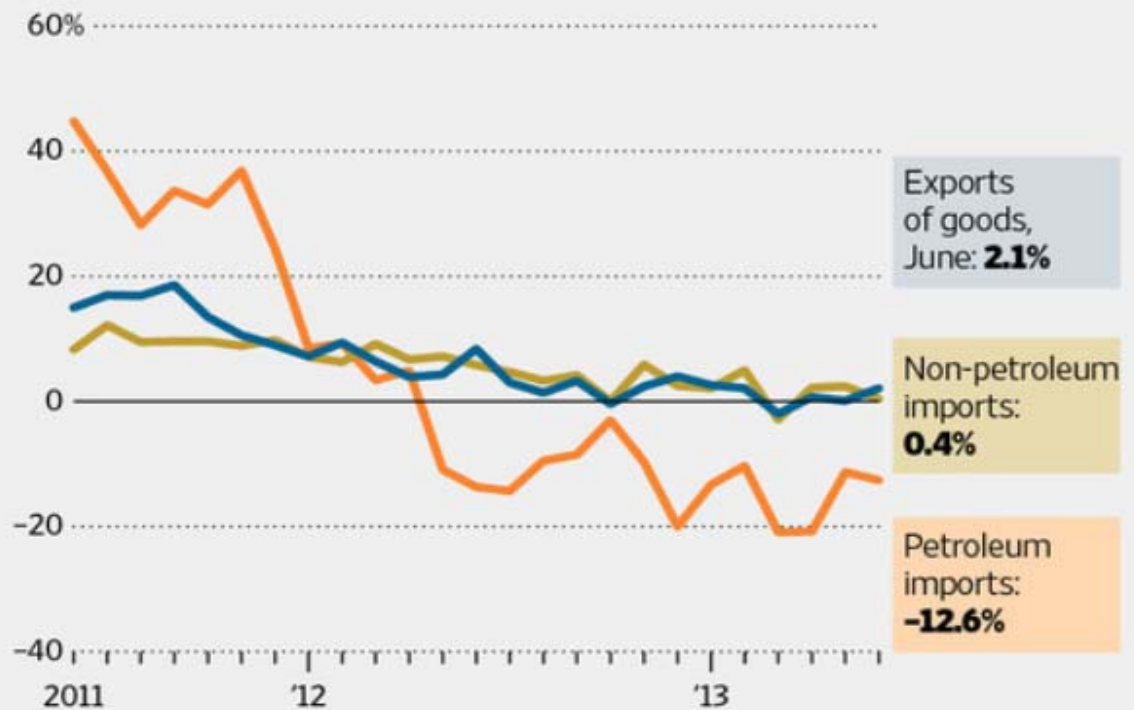
The U.S. trade balance is shifting...

U.S. trade deficit in goods and services, seasonally adjusted

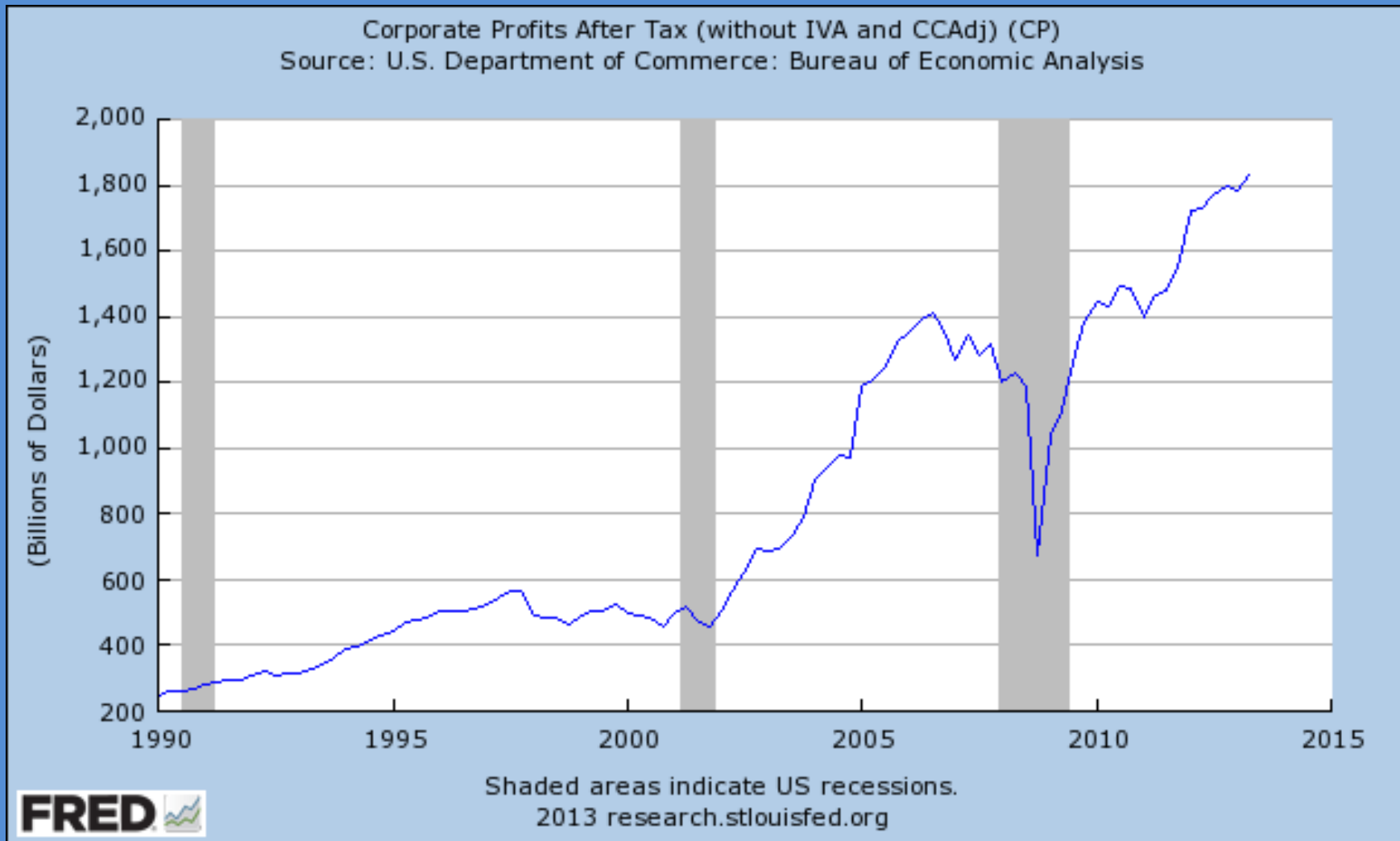


...driven by a drop in imports, due in part to less dependence on foreign oil...

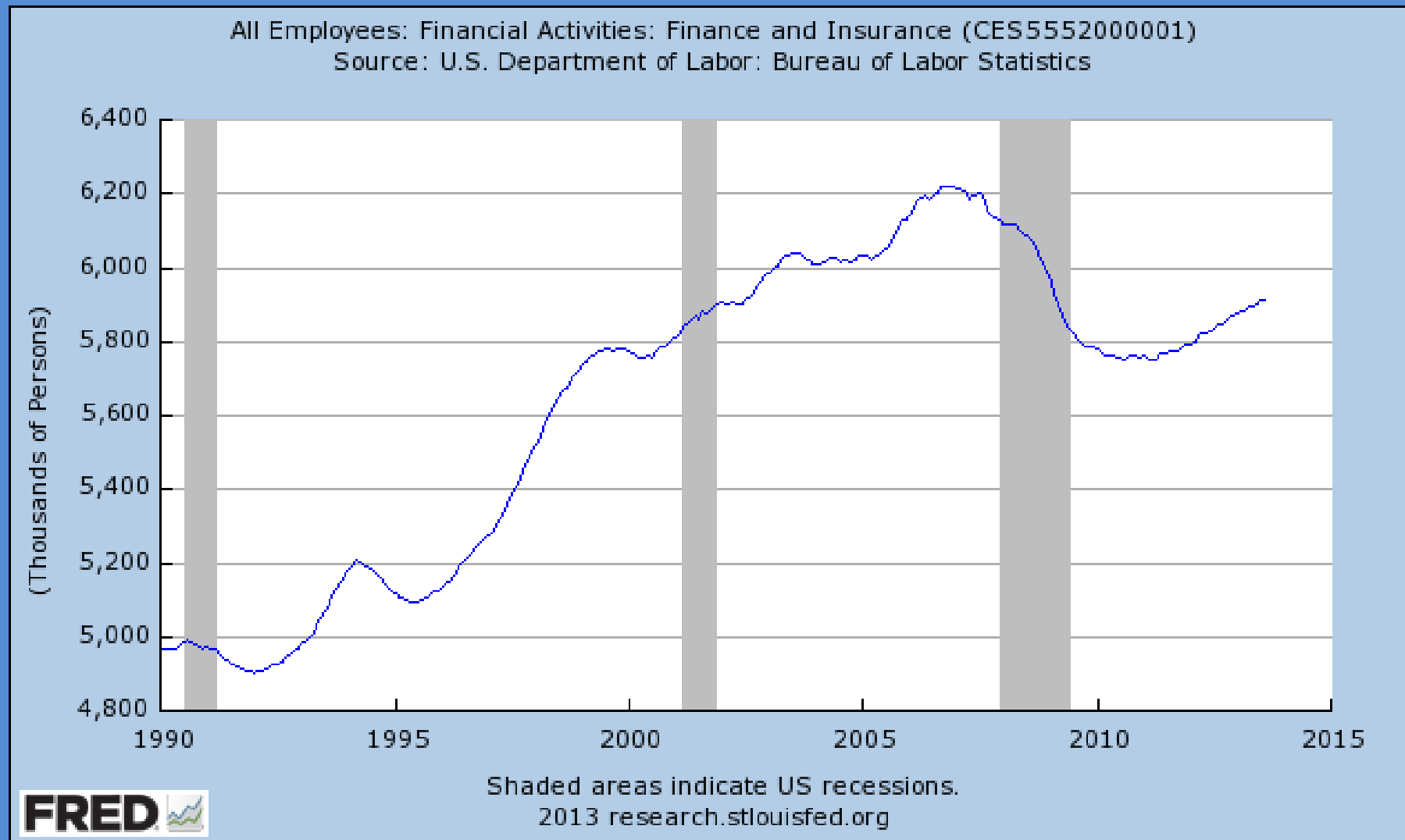
Seasonally adjusted, change from a year earlier



Corporate profits remain strong



However, demand drivers remain weak



Office fundamentals remain challenged

- During the second quarter of 2013 office occupancy increased by 7.2 million square feet (0.2%). . . . that was the biggest increase since the economy began slowing in 2007.
- Overall U.S. vacancy rate stayed flat at 17% in the second quarter of 2013, down from a post-recession peak of 17.6% reached in mid-2010.

What's your strategy?

So what's your strategy given:

- Equity capital market preferences
- Debt capital market preferences
- Growth fundamentals
- Demographic shifts
- Property type fundamentals

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