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Three Current Headlines: Taking a Deeper Dive

[illegible] sector. We aim to put some of these into proper context.

BY MARK G. ROBERTS

Everyone from members of the media to key market participants has been keeping a watchful eye on the U.S. economy, [illegible] to decipher if a recession is imminent or avoidable. Recent negative [illegible] regarding household finances, bank loan activity, and the primary sectors [illegible] commercial real estate [illegible] a bearish picture and might raise concern for some investors. But the headlines are often alarmist, and the data used to support them can lack proper context or a balanced perspective. Digging deeper into the data reveals that there's more to the story.

> ***There are three types of lies: lies, damned lies, and statistics.***
>
> “ ”
>
> MARK TWAIN

KEY HIGHLIGHTS

- Household debt has grown to record levels, but household assets have grown, too – and debt as a percentage of assets has [illegible].
- Across all households, debt as a share of total assets is significantly lower compared to history.
- Given the strength of the fundamentals in apartments, industrial, and even retail, one can discount the risks in these sectors as implied in the headlines.
- The office market is challenged in certain buildings and locations. Yet even assuming a worst-case scenario of building values [illegible] -50%, it implies loan losses of only 0.5% of banks' total assets.
- In the aggregate, the banking sector appears reasonably well [illegible] and commercial real estate risks seem concentrated in certain regions and across certain classes of buildings in the [illegible] market.

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Household Debt

Money Watch recently shared the following about the record-setting level of household debt:

As Exhibit 1 indicates, both statements are true, but they lack context. With a growing population employing more people and a greater number of households each year, debt should continue to record highs every year absent a recession. Importantly, that's only one side of the household in the

As for savings, households were building back their savings even before the COVID-19 stimulus packages. At the start of the GFC in 2008, households had a little more than $500 billion in savings. That amount tripled to a little more than $1.5 trillion by year-end 2019, it doubled again to more than $3 trillion during COVID-19, and it has since fallen back to $2.4 trillion.

Some might argue that total household savings grew because the number of households grew. That's partially true, as the number of households grew 0.8% annually from 2008 to 2021 and total savings increased 11.5% per year. Still, savings per household increased 10.6% per year.

As the pandemic unfolded, there was a tsunami tenant demand for apartments and warehouse space. With supply-chain issues and low unemployment, developers struggled to deliver the supply needed to meet this surge demand. Conversely, because office and retail tenant demand was weak, developers held back on new construction of office and retail buildings.

EXHIBIT 6

Occupancy Rates by Major Property Sector: 1Q 2023 vs. Average of 1Q 2013 – 1Q 2023[6]

Given the strength the fundamentals in apartments, industrial, and even retail, one may be able to discount the risks in these sectors as implied in the headlines. Occupancy rates for apartments, industrial, and retail buildings were near or above the trailing 10-year average at the end 1Q 2023 per CoStar (*Exhibit 6*). Of

Unmasking the Office Sector

Working from home has unsurprisingly taken its toll on the office . And, more recently, some have suggested the risks in the office sector are concentrated in Class B and Class C assets versus Class A office assets. a recent article from CNBC[7] :

“ ”

At the end 1Q 2023, CoStar reported the [illegible] occupancy rate was 87.2%, or 2.1% lower than the long-term average

EXHIBIT 8

For example, tenant demand growth for Class A buildings has been higher, averaging 1.5% per year over the last 20 years, compared to all sectors combined, which grew 0.8% per year. The top-tier subset Class A space that CoStar refers to as "Five Star" buildings and comprises 6% office space in the U.S. has seen even greater tenant demand growth, averaging 4.1% over the last 20 years.

EXHIBIT 9

Office Market Size by Market in $Billions vs. Current Occupancy and Variation in Occupancy[11]

While the size San Francisco office market is only 20% the size the New York office market, San Francisco's fundamentals are weaker than New York's. The current occupancy rate is only 82.7% and well below its 10-year average 91.4% and 2.5

[illegible] assume these loans had a 60% loan-to-value ratio at origination and assume a worst-case scenario that those buildings have [illegible] 50% [illegible] their value. By way [illegible] mparison, co office