

# The NAIOP CRE Sentiment Index

Industry Leaders' Outlook for Commercial Real Estate



FALL 2021

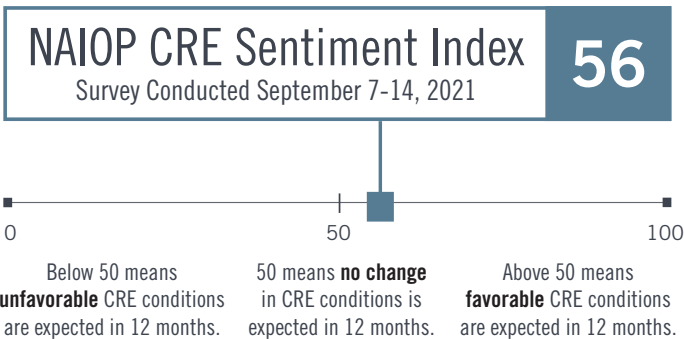
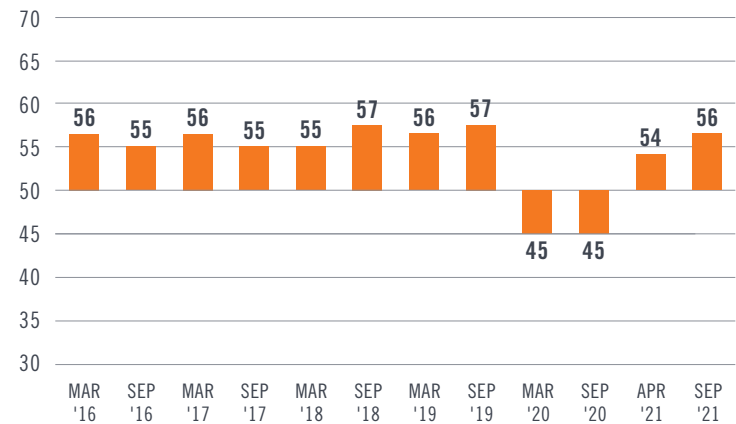


FIGURE 1: COMPOSITE SENTIMENT INDEX, 2016-2021



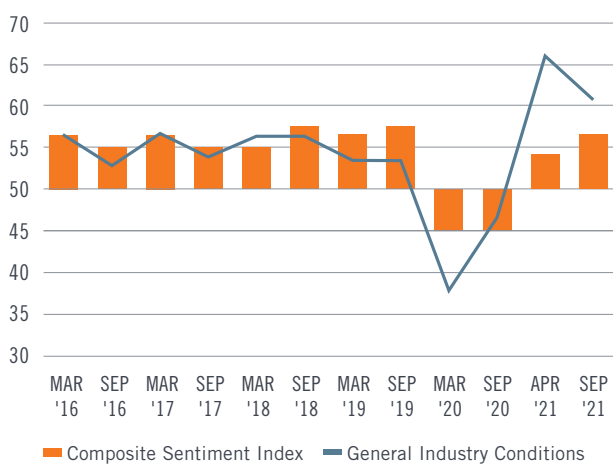
## Key Findings

The NAIOP CRE Sentiment Index for September 2021 is 56, up slightly from April. This indicates that respondents expect conditions for commercial real estate to improve over the next 12 months (see Figure 1). The Index is higher than at any point since the COVID-19 pandemic began and has returned to the level observed in March 2019.

Survey respondents continue to expect most conditions to improve over the next year. The overall outlook remains positive for most market conditions, and it has improved since April for occupancy rates, rents, cap rates and employment within respondents' own firms (see Figures 3 and 4).

Commercial real estate professionals expect construction costs to continue to rise, but they see the pace of material price inflation slowing. Most respondents indicate that construction material and labor costs will increase over the next 12 months, though they are less pessimistic about material costs than in the April survey. This indicates that inflation is less of a concern than it was in the spring.

FIGURE 2: COMPOSITE SENTIMENT INDEX VS. OUTLOOK FOR GENERAL INDUSTRY CONDITIONS, 2016-2021



Respondents remain optimistic about general industry conditions next year. Although slightly less optimistic than in April, respondents expect greater improvement over the next 12 months than in surveys before the pandemic (see Figure 2). The score for general industry conditions (61) is calculated separately from the CRE Sentiment Index and may reflect respondent expectations for other factors that affect the commercial real estate industry, such as macroeconomic conditions.

Overall, respondents remain optimistic about the future, but high levels of variation among their answers to individual questions suggest continued uncertainty. Lower levels of agreement among respondents may also reflect a more challenging environment for some property types and geographic markets. The open-ended comments suggest a brighter outlook for industrial and multifamily properties than for office and retail properties.

A large majority (62.7%) of respondents expect to be most active in projects or transactions related to industrial properties over the next year. Multifamily properties attracted the next largest share of interest (22.6%), followed by office properties (11.9%). Only 2.8% of respondents indicated that they expect to be most active in retail properties.

## Notable Changes from the April 2021 Survey

Figures 3 and 4 compare respondent expectations in September 2021 for the individual components that comprise the NAIOP CRE Sentiment Index to expectations in past surveys. Values above 50 represent expectations that a condition will be more favorable for development in 12 months (e.g., higher face rents, lower construction labor costs or lower cap rates). Values below 50 represent expectations that a condition will be less favorable during the next 12 months.

Respondents are more optimistic about face rents, effective rents, occupancy rates and employment in their own firms than in April, and they expect cap rates to decline in contrast to past expectations that cap rates would increase or remain flat. Respondents are also less pessimistic about the rate at which construction material costs will increase. A score of 31 for materials costs was close to the 2016-2019 average of 29, indicating that respondents expect inflation to moderate. However, some respondents noted that high construction costs and supply shortages continue to affect development projects.

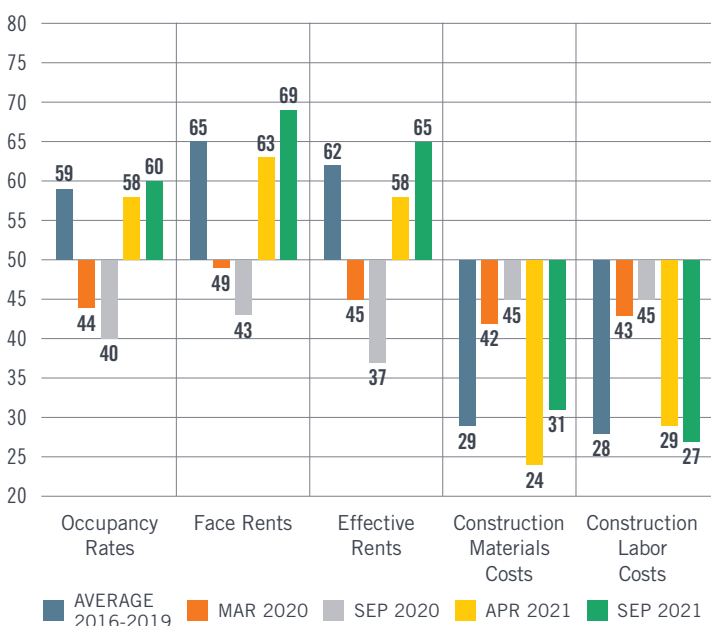
In April 2021, respondents expected a major improvement in general industry conditions (a score of 66) through April 2022. That is a reversal from the 2020 surveys, when they had expected deteriorating conditions. In the current survey, respondents still expect strong improvement in general conditions over the next 12 months, though they expect the pace of improvement through

September 2022 to slow, giving this metric a score of 61. This shift in expectations may be due to respondent concerns about the Delta variant, though it is also possible that they simply expect a gradual return to normal industry conditions. As the pandemic's most severe effects on the industry recede and commercial real estate professionals observe that the most rapid phase of the economic recovery has already occurred, expectations for future improvement should gradually converge with the pre-pandemic range, when respondents expected more modest changes in industry conditions from one year to the next.

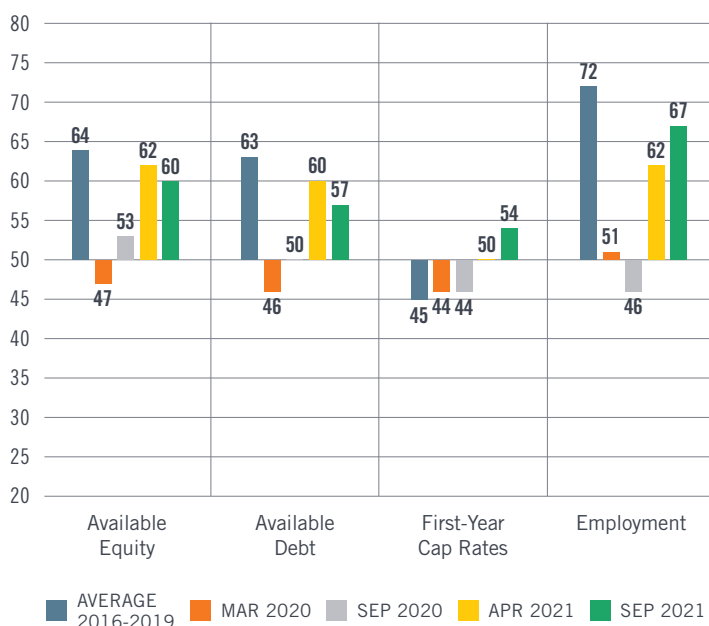
Levels of agreement/disagreement between respondents remain higher than levels recorded in surveys from before the pandemic. This suggests continued uncertainty about future conditions. Lower-than-usual levels of agreement between respondents may suggest that the CRE Sentiment Index for September 2021 is less predictive of future market conditions than surveys from before 2020.

Some of the variation in the survey results may also reflect differences between respondents who specialize in different property types. Open-ended comments suggest that respondents are more optimistic about conditions for industrial and multifamily properties than they are for office or retail properties, with some respondents expressing concerns about the potential effects of the COVID-19 Delta variant on tenant demand for these property types.

**FIGURE 3: SENTIMENT INDEX COMPONENT SCORES: OCCUPANCY, RENTS, CONSTRUCTION COSTS**



**FIGURE 4: SENTIMENT INDEX COMPONENT SCORES: EQUITY, DEBT, CAP RATES, EMPLOYMENT**



## Expectations for Development Conditions

The sentiment survey asks developers and building owners to evaluate how important interest rates, local economic conditions, local development approvals processes, environmental regulations and other government regulations will be to their decisions to initiate or continue development projects over the next 12 months (answers to these questions are not factored into the NAIOP CRE Sentiment Index). The survey then asks developers how favorable they expect these conditions to be. The results are described in Table 1 on a 100-point scale.

Condition	Importance September 2021	Favorability	
		April 2021	September 2021
Local Economic Conditions	85	73	70
Local Development Approvals	78	40	44
Interest Rates	71	68	70
Other Government Regulations	71	39	42
Environmental Regulations	69	39	42

The results of the September survey revealed little change in how respondents view these development conditions over the next 12 months. Local economic conditions and development approvals remain the two most important conditions to respondents, and their views on the favorability of each condition have not changed much since April. Respondents continue to expect local economic conditions and interest rates to be supportive of development, and for local development approvals, environmental regulations and government regulations to be slightly unfavorable. Open-ended comments from some respondents also reflect concerns about development approvals and local and federal regulation.

## Differences Between Developers and Non-Developers

Respondents were asked to identify their primary profession. When comparing the responses of developers and building owners to non-developers, two statistically significant differences related to the conditions that comprise the sentiment index emerged (see Table 2). While both groups have a positive outlook on face rents and general industry conditions, developers and owners are slightly more optimistic about face rents than other respondents, while non-developers are slightly more optimistic about general industry conditions than developers and owners. Differing expectations about future rents may lead non-developers to value commercial properties and new development more conservatively than developers.

Metric	Average of All Respondents	Developers and Building Owners	Non-Developers
Face Rents	69	72	66
General Industry Conditions	61	58	63

## Direct From Survey Participants

“Lack of supply across multifamily, single-family rental and industrial are our main issues presently. We are seeing increased interest in investment office, while owner-user office seems to be continuing its momentum.”

“West Coast industrial markets continue to strengthen amid strong demand in the e-commerce, manufacturing and life science sectors.”

“I think that I would have been much more optimistic about the next 12 months were there more positive news about containing and working through the Delta variant. Unfortunately, that is not the case, and it appears that the ‘return to office’ has been delayed again.”

“The return to a formal office setting remains to be determined, but early indications are that companies [plan] to reduce space and rents as leases expire.”

“Labor and material shortages will continue to drive costs up over the next 12 months. Once these two stabilize, costs will continue to escalate, but not at the rates we have seen over the past year.”

“Supply constraints in many segments (including the need for larger-box space) continue to put pressure on delivery across the board. I’m concerned that an extended supply impact will ultimately diminish demand.”

“Approvals for ground-up development with local municipal and state jurisdictions remain a challenge.”

“Increased taxes and regulations will hurt the market, in some cases severely.”

## Methodology

The NAIOP Sentiment Index is designed to predict general conditions in the commercial real estate industry over the next 12 months by asking industry professionals to predict conditions for their own projects and markets. The NAIOP CRE Sentiment Survey is conducted biannually, in March/April and August/September. The survey is sent to roughly 9,000 NAIOP members in the U.S. who are developers, building owners, building managers, brokers, analysts, consultants, lenders and investors in the office, industrial, retail and multifamily sectors. It asks questions about jobs, space markets, construction costs, capital markets and other conditions for real estate development. The questions that comprise the Sentiment Index are not equally weighted. Instead, weighting varies based on whether responses to a question are tightly packed or dispersed. Questions with tightly packed responses (meaning there is more consistency among the answers to that question) are more heavily weighted than those with more dispersed responses (which indicate less consistency).

If every participant in the survey selected the most optimistic answer to every question, the index would be 100. Conversely, if all the participants chose the most pessimistic response to every question, the index would be 0. The survey includes questions that evaluate sentiment about conditions that are not included in the composite sentiment index score but are measured separately on a 100-point scale.

A cross-tabulation of the September survey results by respondent profession revealed only two differences that were both observable (at least one point apart on a 100-point scale) and statistically significant. Differences that were not observable or statistically significant are not reported in this analysis.

A total of 357 respondents from 263 distinct companies participated in this survey. When individuals were asked what property types they worked on, 71.5% indicated they work on industrial properties, 65.0% work on office properties, 39.8% work on retail properties and 38.4% work on multifamily properties. A regional breakdown shows that 51.4% of respondents are active in the West, 34.5% are active in the East, 36.7% are active in the South and 26.0% are active in the Midwest.

Survey participants receive a summary of results showing the percentage breakdown of responses to each question after the survey closes. This report is released to all NAIOP members and the public three to four weeks later. Survey responses for this index were gathered between September 7 and 14, 2021. The response rate for this survey was 3.89%, and the margin of error for the composite index score was 5.23%.

The statistical methodology for the Sentiment Index was originally developed by Tom Hamilton, Ph.D., MAI, CCIM, CRE, the Gerald Fogelson Distinguished Chair of Real Estate in the Chicago School of Real Estate at Roosevelt University. The survey data was collected by NAIOP, and the survey questions were created, refined and finalized between 2014 and 2021 with the assistance of several NAIOP Distinguished Fellows. NAIOP's Director of Research, Shawn Moura, Ph.D., authored the current edition of the survey and this summary analysis. For questions about the CRE Sentiment Index, please contact Shawn at [moura@naiop.org](mailto:moura@naiop.org).

## Media Inquiries

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