

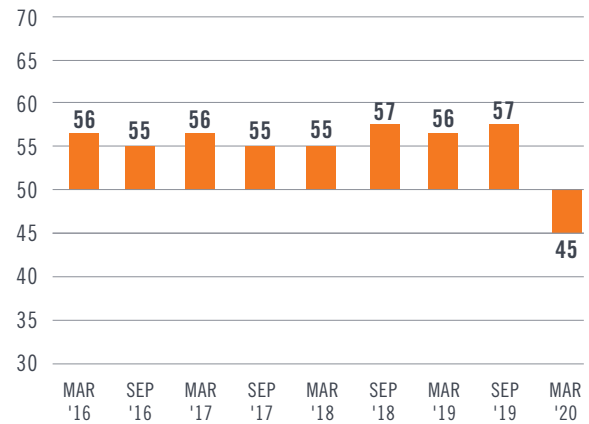
The NAIOP CRE Sentiment Index

Industry Leaders' Outlook for Commercial Real Estate



SPRING 2020

FIGURE 1: COMPOSITE SENTIMENT INDEX SCORE, 2016-2020



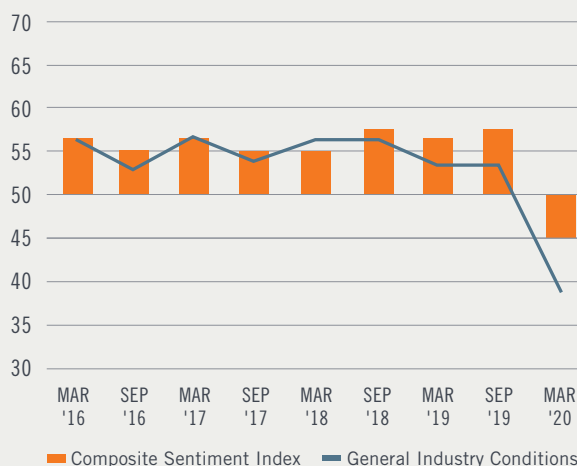
Below 50 means **unfavorable** CRE conditions are expected in 12 months. 50 means **no change** in CRE conditions is expected in 12 months. Above 50 means **favorable** CRE conditions are expected in 12 months.

A Note About the March 2020 Survey

The NAIOP CRE Sentiment Index was designed to estimate 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. **However, the March 2020 survey that informs the index was conducted between March 11 and March 25, a period of rapidly increasing economic uncertainty associated with the coronavirus outbreak.**

The survey data and comments from respondents reflect this growing uncertainty. Given the added difficulty of forecasting future market conditions during this period, the March survey results are better understood as a snapshot of industry sentiment than as a reliable predictor of future market conditions.

FIGURE 2: COMPOSITE SENTIMENT INDEX VS. OUTLOOK FOR GENERAL INDUSTRY CONDITIONS, 2016-2020



Key Findings

The NAIOP CRE Sentiment Index for March 2020 is 45, falling below 50 for the first time since the index began in 2016. This is a substantial drop from September 2019 (57; see Figure 1).

Respondent expectations for general industry conditions, measured separately from the index, fell even more sharply, from a score of 53 to a 38. (see Figure 2). This measurement, which allows for a comparison between respondents' general outlook for the commercial real estate industry as a whole and expectations about their own projects and markets, has usually been within a few points of the Sentiment Index in past surveys. A sharply lower outlook for general industry conditions suggests that respondents were more pessimistic about general conditions than the fundamentals of their own projects and markets.

Respondents provided a slightly negative outlook on every condition that comprises the index (occupancy rates, face rents, effective rents, construction materials costs, construction labor costs, equity and debt availability, and first-year cap rates) **except for employment within their own firms**, which they expected to be almost flat (a score of 51 on a 100-point scale; see Figure 3, page 2).

There was **greater variation** in the range of answers that respondents provided to individual survey questions than in the past, **suggesting increased uncertainty about future industry conditions.**

Respondents' expectations about general industry conditions fell between the first seven days and the last eight days of the survey. Comments from survey respondents also suggest that sentiment had deteriorated since the survey first began in mid-March and that it had become more difficult to predict future industry conditions (see the Direct from Survey Participants section, page 3).

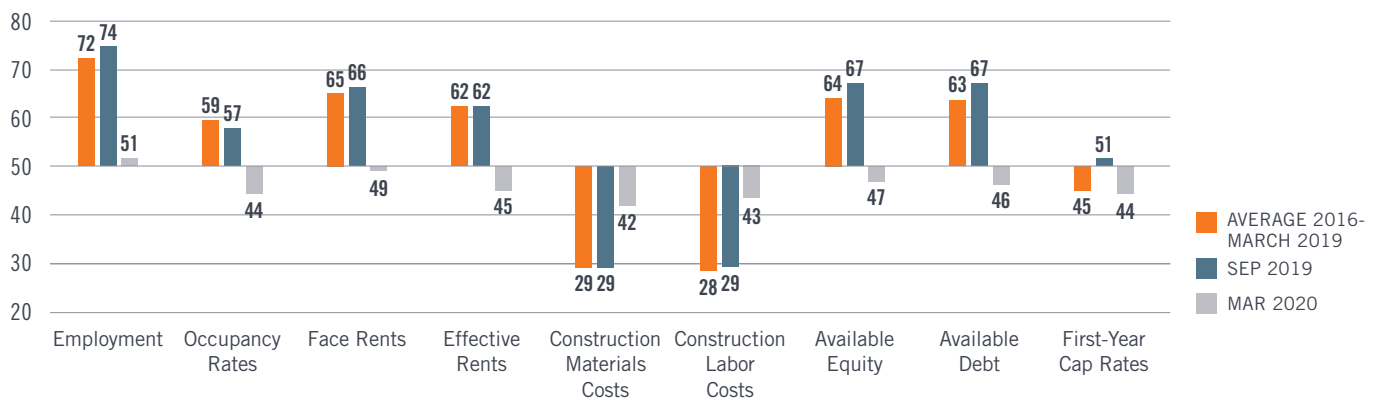
Notable Changes from the September 2019 Survey

Figure 3 compares respondent expectations in March 2020 for the individual components that comprise the NAIOP CRE Sentiment Index to respondent 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.

Respondent projections were significantly less favorable for development than in September 2019 for every condition except construction materials and construction labor costs. Respondents expected construction costs to be higher in 12 months, but expected these costs to grow less rapidly than they had in September. While slower growth in these costs may be favorable for development, this difference could also signal that respondents believe there will be less demand for materials and labor due to a slowdown in the construction industry.

The March 2020 survey included a new question for developers on whether they expected the overall dollar value of their projects and acquisitions to grow or shrink over the next 12 months (not pictured). This question allows for an evaluation of developer intentions in addition to their outlook for market conditions. On average, respondents indicated that they expected their own development and acquisitions activity to shrink slightly over the next 12 months, with a score of 44. This figure is close to the composite index score of 45, suggesting that developer intentions closely align with their expectations for future market conditions.

FIGURE 3: NAIOP CRE SENTIMENT INDEX COMPONENT SCORES



New Data: Expectations for Development Conditions

For the first time, the March 2020 survey asked developers to evaluate how important interest rates, local economic conditions, local development approvals processes, environmental regulations, and other government regulations would be to their decisions to initiate or continue development projects over the next 12 months (the answers were not factored into the NAIOP CRE Sentiment Index). The survey then asked developers how favorable they expected these conditions to be. The results are described in Table 1 on a 100-point scale.

TABLE 1: IMPORTANCE AND FAVORABILITY OF DEVELOPMENT CONDITIONS OVER THE NEXT 12 MONTHS

Condition	Importance	Favorability
Local Economic Conditions	88	53
Local Development Approvals	77	42
Environmental Regulations	71	42
Other Government Regulations	71	43
Interest Rates	70	80

Respondents expected economic conditions — the factor they considered most important — to be only slightly favorable (above 50). While also important, they were less optimistic about local development approvals processes, environmental regulations, and other government regulations such as taxes or rent control (the survey did not foresee mandatory business closures associated with the outbreak, but some respondents may have taken these into account). Respondents indicated that they expect interest rates to be very favorable for development in the months ahead. While the survey was fielded, the Federal Reserve cut interest rates and indicated that it would take additional steps to increase liquidity in response to the outbreak.

New Data: Comparisons Among Professions and Property Types

Two differences emerged when comparing the responses of developers to non-developers (see table 2). On average, developers indicated that it was slightly unlikely their firms would hire employees in the next 12 months, while non-developers indicated their firms were slightly likely to hire more employees. Developers were also slightly more pessimistic about industry conditions than non-developers about general industry conditions in 12 months.

TABLE 2: DIFFERENCES BETWEEN DEVELOPERS AND NON-DEVELOPERS

Metric	All Respondents	Developers and Building Owners	Non-Developers
Employment	51	48	56
General Industry Conditions	38	35	40

There were two observable and statistically significant differences in the results when comparing respondent specialization by property type (see table 3). At the time of this survey, professionals specializing in office properties were the least pessimistic about occupancy rates, followed by those who specialize in industrial properties and multifamily properties. Multifamily developers found interest rates to be more important to their development decisions than office or industrial developers.¹

TABLE 3: DIFFERENCES BY PROPERTY TYPE

Metric	All Developers and Building Owners	Office	Industrial	Multifamily
Occupancy Rates	44	49	44	41
Importance of Interest Rates	70	70	66	81

Direct From Survey Participants

“I would have answered the survey differently two weeks, ago but coronavirus has us all a bit uncertain.”

“I'm submitting this survey at the beginning of a broad shutdown due to the coronavirus, but I'm hopeful the impact will only last about a month.”

“COVID-19 is a wild card. Hopefully it will be short-lived and we'll be back to normal soon. But it certainly has shaken things up. With the volatility in the stock market, it could push people to invest in real estate.”

“The coronavirus and record-low oil and gas prices are creating unanticipated risks that could be very damaging.”

“I believe the greatest known unknown is the extent to which COVID-19 and geopolitical upheaval will impact supply chains and capital availability.”

“With the current evolving virus crisis now severely impacting the economy, the immediate future of real estate investments are impossible to predict but appear to be much worse than previously thought. The next few months will tell, but a recession is at hand, and reactions in real estate typically will take 24+ months of recovery once the bottom is reached.”

“We are already seeing banks say they are not willing to lend to new clients in multifamily. They will service existing relationships but not do new relationships for lending.”

“I expect the next at least six months to be very tough due to COVID-19. I expect slower economic activity resulting in lower rents, lower prices and increased vacancy. However, once the virus fears are cleared, I expect a rapid recovery. Whether that recovery happens in 12 months or later is unclear.”

“The response and recovery to the coronavirus will heavily dictate where real estate goes in the next 12 months. If the government can ensure this is a temporary blip as opposed to an ongoing crisis, the industry will be much better off. If not, it could be a domino effect of tenants not paying rent, landlords short on debt payments, lending institutions short on cash, etc.”

“Coronavirus presents challenges to our industry we need to explore. Will we work from home? Will we not go out to restaurants and shop? How will we network?”

Methodology

The NAIOP CRE Sentiment Survey is conducted biannually, in March and September. The survey is sent to roughly 10,500 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 NAIOP CRE 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 of the participants chose the most pessimistic response to every question, the index would be 0.

The March 2020 survey was fielded to a broader range of NAIOP members than past surveys. It included new questions that allow for comparisons between developers or building owners and non-developer respondents (building managers, brokers, analysts, consultants, lenders, non-developer investors and other commercial real estate professionals) and comparisons in sentiment between practitioners who specialize in different property types (office, industrial, retail, multifamily).

Cross tabulations of the survey results revealed very few 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. The survey also included new questions evaluating sentiment about conditions that are not included in the composite sentiment index score.

Some individual questions were slightly reworded from past surveys to accommodate non-developer respondents, but the core meaning of each question that comprises the NAIOP CRE Sentiment Index remained the same. To make easier comparisons between responses to individual questions and the composite index score, NAIOP converted all results to a 100-point scale.

A total of 439 distinct companies are represented in this survey. Product types owned/under development by respondents broke out to roughly 21% office, 50% industrial, 5% retail and 25% multifamily; western regions were slightly more represented than eastern regions, followed by the South and 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 March 11 and March 25, 2020. The response rate for this survey was 5.92%, and the margin of error for the composite index score was 4.02%.

The statistical methodology for the NAIOP CRE 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 2020 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 NAIOP CRE Sentiment Index, please contact Shawn at moura@naiop.org.

Endnote

¹ Only 30 respondents indicated they specialized in retail real estate. Observable differences between these respondents and other respondents are not statistically significant. NAIOP did not evaluate differences in firm employment projections by property type, as an individual respondent's sectoral specialization may not be representative of their entire firm. For this question, differences between professions are likely to be more meaningful than differences by property type.