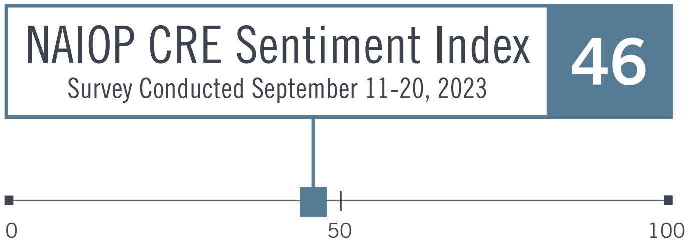
The NAIOP CRE Sentiment Index

Industry Leaders' Outlook for Commercial Real Estate

FALL 2023

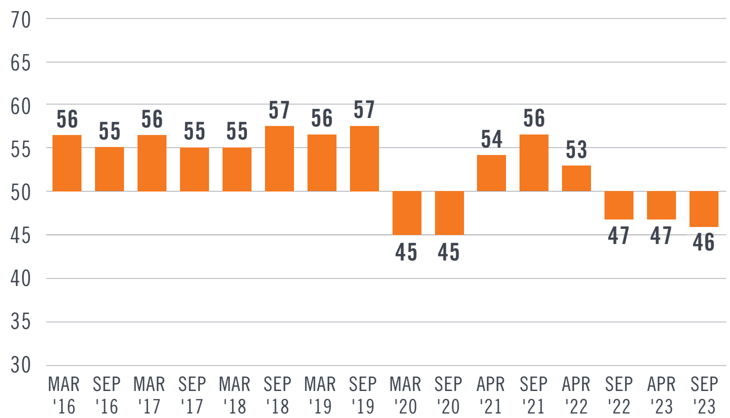


Below 50 means **unfavorable** CRE conditions are expected in 12 months.

50 means **no change** in CRE conditions is expected in 12 months.

Above 50 means **favorable** CRE conditions are expected in 12 months.

FIGURE 1: **COMPOSITE SENTIMENT INDEX, 2016-2023**



Key Findings

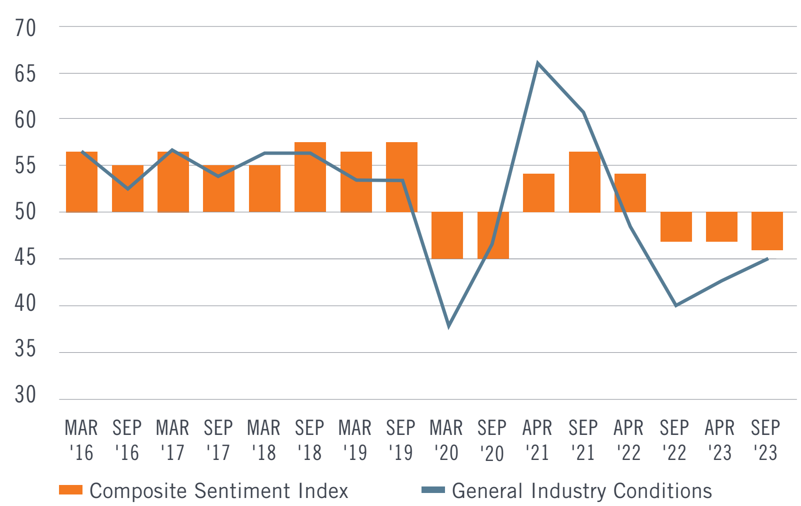
The NAIOP CRE Sentiment Index for September 2023 is 46, slightly down from the April 2023 reading, and indicating that respondents expect conditions for commercial real estate to worsen over the next 12 months (see Figure 1).

Respondents have a negative outlook for every component that comprises the Index except for asking rents, which they expect to be slightly higher next year. However, they now expect effective rents to fall slightly more than they had predicted in April, and their outlook for occupancy rates remains negative, suggesting higher asking rents will provide little relief.

Respondents now expect capital market conditions to deteriorate less rapidly than they had predicted in April. They expect future equity availability will be almost as high as it is now, suggesting that equity flows may be close to bottoming out. Nonetheless, they still expect debt to be less available than it is now, and for cap rates to increase. In response to a question that is not used to calculate the Index, developers and building owners indicated they expect interest rates to be slightly higher than they had predicted in April.

Developers and building owners expect their own deal volume to shrink but at a slower rate than in April. Their outlook for a reduction in the dollar volume of new projects and acquisitions echoes respondents' expectations for a slowing decline in capital availability.

FIGURE 2: **COMPOSITE SENTIMENT INDEX VS. OUTLOOK FOR GENERAL INDUSTRY CONDITIONS, 2016-2023**



Respondents still expect general industry conditions to worsen, but less than they previously expected (see Figure 2). The score for general industry conditions (45) is calculated separately from the CRE Sentiment Index. Its continued rebound is most likely due to a less pessimistic outlook for the economy overall. Asked separately from the questions that comprise the Index, developers and building owners indicated they expect no change in local economic conditions over the next 12 months, an improvement from April.

Respondents now expect employment in their own firms to decline slightly over the next year, suggesting that deteriorating market conditions are now being felt more directly by commercial real estate firms.

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Two-thirds of respondents expect to be most active in either industrial or multifamily real estate during the next 12 months (see Table 1). Respondents expect to be about equally active in office, mixed-use and retail properties, with specialty property types attracting less interest.

TABLE 1: **PROPERTY TYPES WHERE RESPONDENTS EXPECT TO BE MOST ACTIVE OVER THE NEXT 12 MONTHS**

Property Type	Percentage
Industrial	46.5%
Multifamily	21.5%
Office	7.5%
Mixed-use	7.3%
Retail	6.8%
Medical Office	4.0%
Data Center	1.8%
Hospitality	1.5%
Life Science	1.5%
Other	1.3%
Self-storage	0.5%

Notable Changes in the September 2023 Survey

Figures 3 and 4 compare respondent expectations in September 2023 for the individual components that comprise the NAIOP CRE Sentiment Index to expectations in past surveys. For component scores from before 2020, please refer to past editions of this report. 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.

Most shifts in respondent perceptions since the April survey were quite small, especially in comparison to much larger shifts in previous surveys. Of the nine metrics that comprise the CRE Sentiment Index, six only shifted by one or two points since April. The largest shift was in perceptions of employment within the respondents' own firm, which changed by only four points, from slightly optimistic (51) to slightly pessimistic (47). The only other metric that changed direction was respondent perception of construction material costs. In April, respondents expected those costs to decrease very slightly (51), whereas they now expect them to increase very slightly (49).

Nonetheless, the three capital market indicators all moved in the same direction. As noted earlier, respondents appear hopeful that equity availability may soon recover, but they expect continued contraction in debt markets and rising cap rates, albeit at a slower pace than in April. Some open-ended comments suggest that capital will become more available as transactions grow, providing market participants with better insight into property valuations.

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

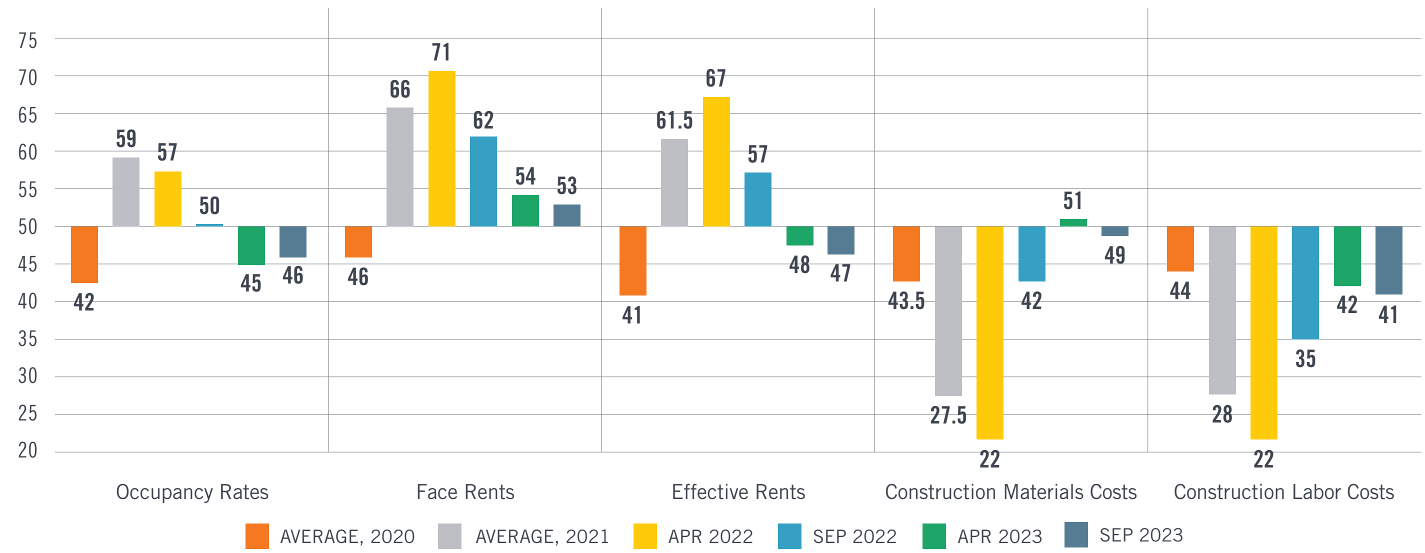
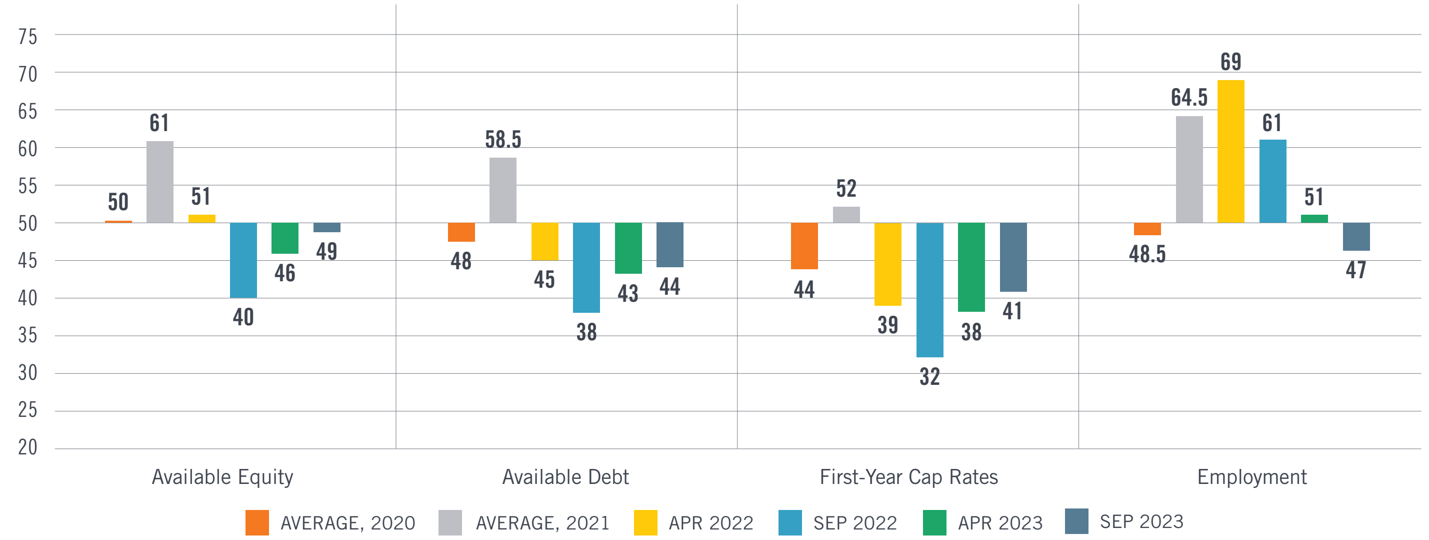


FIGURE 4: **SENTIMENT INDEX COMPONENT SCORES: EQUITY, DEBT, CAP RATES, EMPLOYMENT**



Expectations for Development Conditions

The 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 2 on a 100-point scale.

TABLE 2: **IMPORTANCE AND FAVORABILITY OF DEVELOPMENT CONDITIONS OVER THE NEXT 12 MONTHS**

Condition	Importance, September 2023	Favorability	
		April 2023	September 2023
Interest Rates	82	23	22
Local Economic Conditions	80	47	50
Local Development Approvals	72	39	40
Environmental Regulations	66	38	40
Other Government Regulations	64	36	39

Respondents continue to rate interest rates as slightly more important than local economic conditions in their development decisions, and they continue to expect that interest rates will be unfavorable for development. Their outlook for local economic conditions has improved somewhat to be neither favorable nor unfavorable. They expect local development approvals, environmental regulations and other government regulations to be slightly less unfavorable than they previously expected. In open-ended comments, several respondents mentioned headwinds presented by local or state policies such as environmental regulations, multifamily rent controls, and restrictions on industrial development.

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, only one statistically significant difference emerged: developers are slightly more optimistic (score of 50) than non-developers (score of 44) about future effective rents. Differing expectations about future rents may lead non-developers to value commercial properties and new development more conservatively than developers.

Direct From Survey Participants

"Overall, the general real estate market will be in a healthier state in 12 months as I believe there will be more transaction volume, which means more data points and ultimately more transparency into pricing."

"Financing deals will continue to be difficult to put together. The number of sources a developer must go to put a deal together has increased in 2023 and will continue [to increase] in 2024 as increased rates have put pressure on bank balance sheets. Banks are also being more selective […] and want to increase credit quality."

"The office sector is shifting in many ways and still a vital part of our economy. Return to the office statistics are up but that demand is still trailing supply dramatically and will for the intermediate term."

"The office market is definitely in a recession at the moment."

"While I expect industrial leasing volume to slow somewhat this will be counterbalanced by the fact that there will be little to no new speculative product delivered to the market in late 2024 and even less in early 2025 because of the lack of financing that is available today."

"[Our] biggest concern is local jurisdictions trying to legislate supply and demand characteristics."

"[It is a] confusing time; as confusing as I have seen in my 25-year career. While the headlines are tough and values are in flux, the Main Street economy is doing well. Jobs are plentiful and the U.S. continues to innovate."

Methodology

The NAIOP CRE 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 10,000 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 one difference that was statistically significant. Differences that were not statistically significant are not reported in this analysis.

A total of 400 respondents from 295 distinct companies participated in this survey. A breakdown of the property types that respondents work on is provided in Table 3.

A regional breakdown shows that 49.3% of respondents are active in the West, 40.8% are active in the South, 30.8% are active in the East and 24.8% 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 11 and September 20. The response rate for this survey was 3.7%, and the margin of error for the composite index score was 4.9%.

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 2023 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**.

TABLE 3: **RESPONDENT PROPERTY TYPES**

Property Type	Percentage*
Industrial	73.8%
Office	55.5%
Multifamily	43.5%
Retail	42%
Mixed-use	37%
Medical Office	27.8%
Hospitality	17.3%
Life Science	14.3%
Self-storage	14.3%
Data Center	8.8%
Other	6.3%

*As respondents can work on multiple property types, combined total across property types exceeds 100%.

Media Inquiries

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