

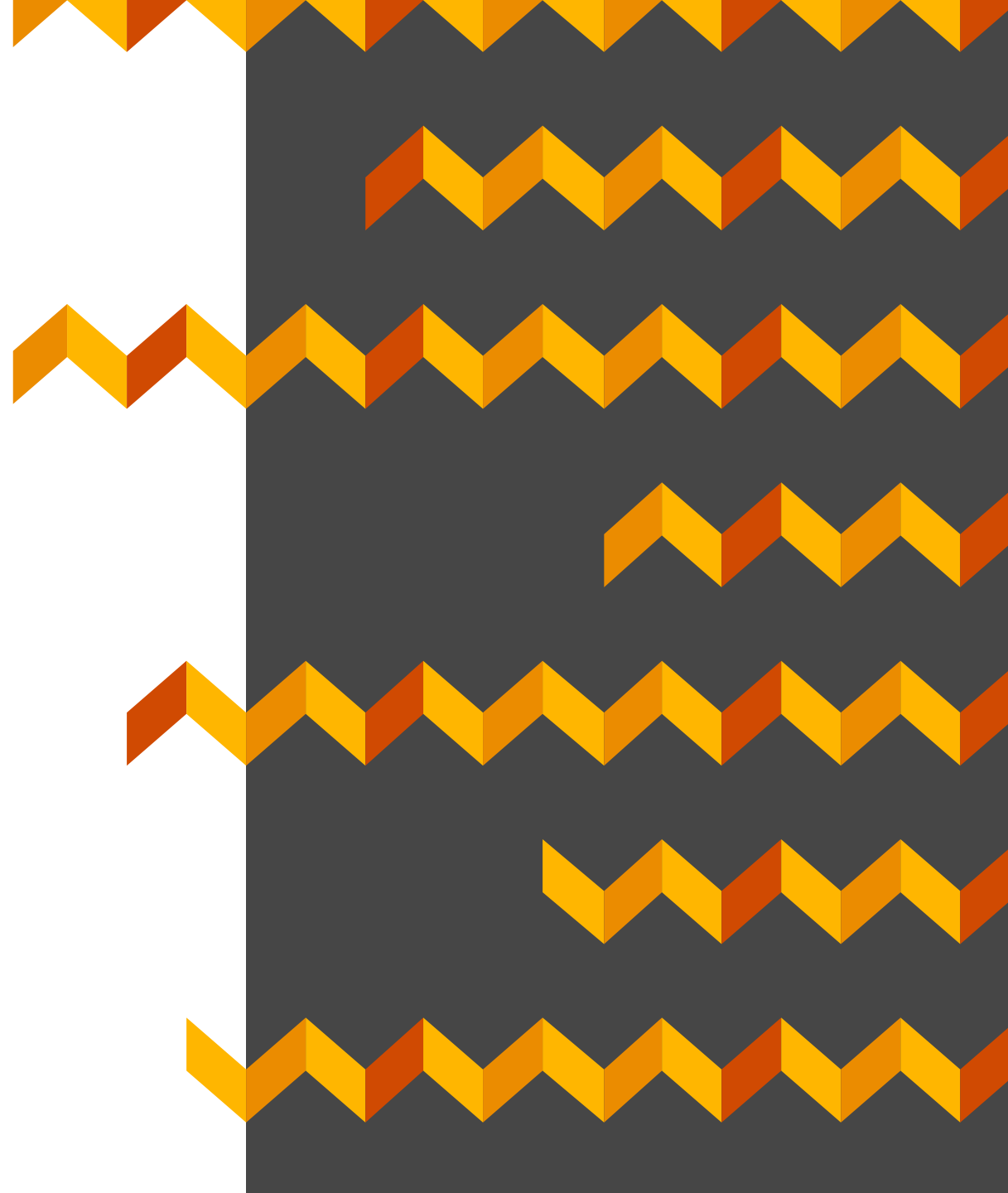
Navigating rising cap rates

Investor Survey highlights for second quarter 2023



Investor Survey

A PwC Product



Commercial real estate (CRE) is changing in unprecedented ways. With the Federal Reserve signaling further increases in interest rates and the economy showing some signs of slowing, overall capitalization rates (cap rates) across nearly all property sectors are climbing – some quite dramatically.

Investors are watching closely, keeping tabs on market movement and underlying fundamentals. Investor Survey, a PwC product, is an essential tool for understanding how the CRE sectors are being shaped by powerful economic winds. With in-depth data points across markets and time periods, as well as commentary derived from surveying active investors, Investor Survey delivers valuable insights to help you make better-informed decisions.

In the second quarter of 2023, the survey provides an important window into how each of the four major sectors, as well as how city and regional markets are adjusting to these times.



Interest rates and overall cap rates on the rise

The past 15 months have dramatically altered the investment environment for CRE. Since March 2022, the Federal Reserve (Fed) has raised interest rates a total of 500 basis points. In response, overall cap rates have risen. In 35 survey markets, average overall cap rates are higher today than they were a year ago, up an average of 77 basis points.

No sector has experienced as much change as the office sector, where in addition to rising interest rates, the aftermath of the pandemic and turmoil in the financial sector have increased investment risk.

The combined average overall cap rate for the survey's 19 city-specific office markets has steadily pushed higher each quarter since the first quarter of 2022. As of this quarter, the combined average now stands 93 basis points higher than it was 15 months ago. Several city-specific office markets recorded some of the largest increases in their average overall cap rate this past year, including Atlanta and Austin, both up 142 basis points, Seattle, up 138 basis points, and Houston, up 126 basis points.

Certain segments of CRE, however, have shown resilience and are performing quite well even amid the stresses. Retail, for instance, continues to bounce back, "especially well-located assets with quality tenancy," according to one investor. Investor Survey provides extensive data as to how cap rates are changing – and how investors expect them to change in the near term.

Office markets with largest overall cap rate changes*

Atlanta

+142

basis points

Austin

+142

basis points

Pacific Northwest

+142

basis points

Seattle

+138

basis points

*Represents the year-over-year average cap rate change from 2Q 2022 to 2Q 2023.

How long until office cap rates peak?

Given the relationship between interest rates and overall cap rates, investors are closely tracking the Fed's next moves. Investor Survey takes the pulse of expectations specifically in the office sector. Across the three national and 19 city-specific office markets, investors unanimously feel that the Fed will raise interest rates again during the remainder of 2023, with the consensus being at least one more increase. On average, investors expect an increase of 25 basis points.

Not surprisingly, 76% of surveyed investors also envision overall cap rates in office markets increasing over the next six months.

“Even if interest rates don’t increase any more,” said one investor, “we see cap rates rising due to risk, whether perceived or actual.”

Office market investors expect additional cap rate increases of up to 200 basis points and an average of 77 basis points.

Not surprisingly

76%

of surveyed investors anticipate overall cap rates increases over the next six months

Across the 35 surveyed markets, investors expect overall cap rates to increase in 27 markets and to hold steady in six markets over the next six months. The remaining two markets are evenly divided between expecting cap rates to increase or hold steady.

Office market investors in particular are bracing for these increases to persist well into 2024. According to our survey, the average expected time for overall cap rates to peak across the surveyed office markets is 12 months, with the national suburban office market's highest average time frame for cap rates to peak at 15.6 months, while the Austin office market has the lowest average duration to peak at 7.9 months. Additionally, office markets in Austin, Boston, Dallas, Manhattan and San Francisco have the highest proportion of expected cap rate increases in the next six months.



Shifting real estate cycles

Our PwC Real Estate Barometer analysis, included in Investor Survey, explores how cycles vary across markets and geographic locations based on property type – office, retail, industrial and multifamily.

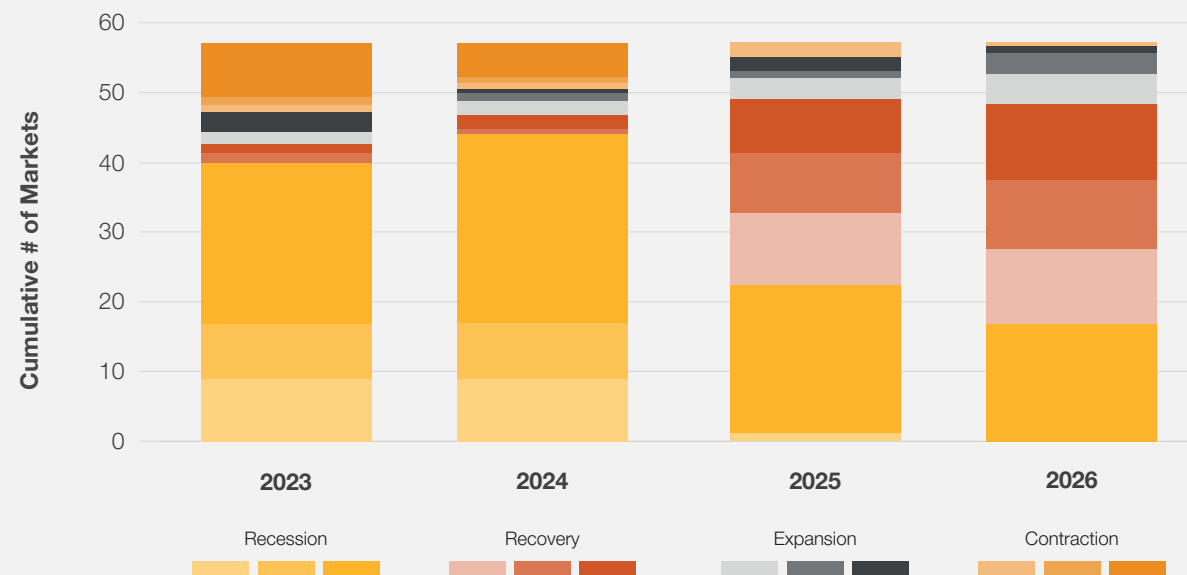
The ongoing reset in the US office sector is evident and likely to continue for a while. Many companies continue to rethink space needs, downsizing and returning space to the market at lease expiration.

In fact, 64% of office market investors report that leasing activity has slowed over the past three months.

Organizations now occupy less office space per employee than ever before and vacancy has reportedly reached a record high primarily due to a surge in sublet space. Investors predict that nearly 70% of the 57 office metros analyzed may be in recession this year, increasing in number in 2024 and then a subsequent decline in 2025.

PwC Real Estate Barometer US Office Markets - 2023 to 2026

Chart REB-1

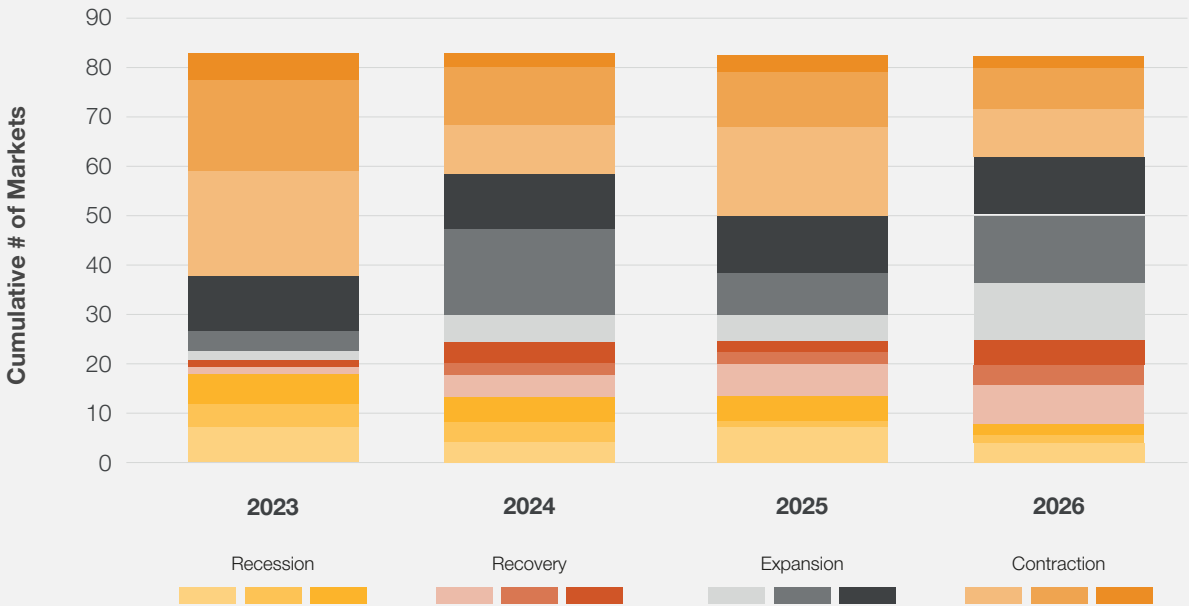


Source: Data provided by CBRE, compiled and analyzed by PwC

In the US apartment sector, a supply-demand imbalance has significantly pushed up the national vacancy rate from its record low in the third quarter of 2021. As a result, our analysis places 22% of metros in recession and 55% in contraction in 2023.

PwC Real Estate Barometer
US Multifamily Markets - 2023 to 2026

Chart REB-4



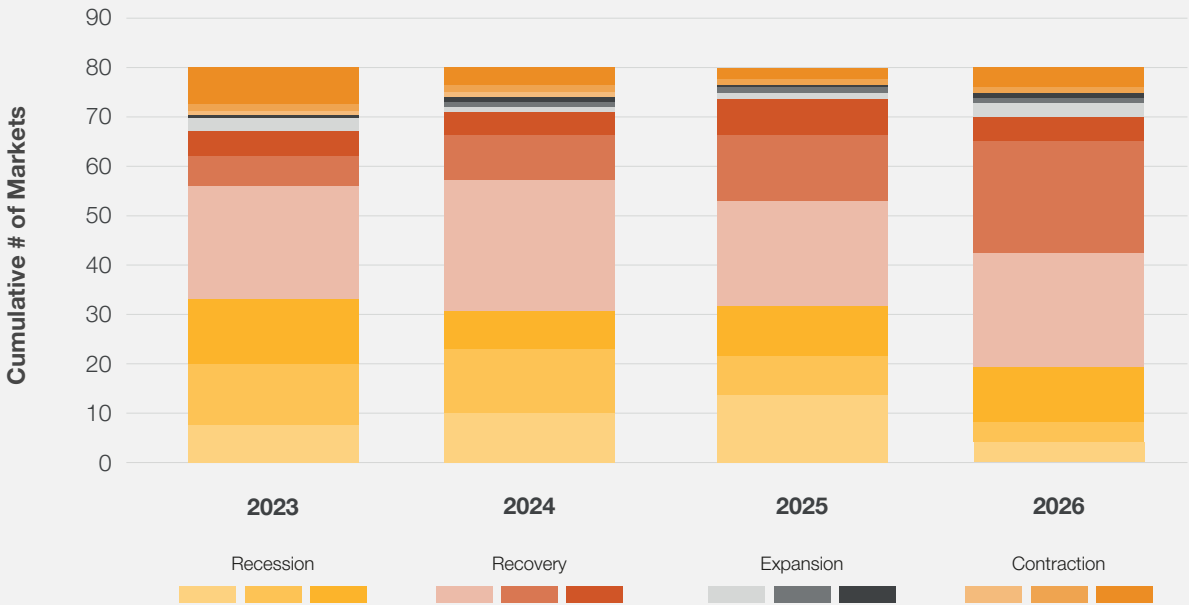
Source: Data provided by Moody's Analytics, compiled and analyzed by PwC

Prospects are better in the US retail sector, which is currently experiencing its tightest vacancy on record, due to a combination of strong consumer spending, only modest construction activity and continuous demolitions removing outdated inventory.

Among the 80 metros examined, our analysis indicates that a growing portion will be in recovery through 2026.

PwC Real Estate Barometer
US Retail Markets - 2023 to 2026

Chart REB-2



Source: Data provided by Moody's Analytics, compiled and analyzed by PwC

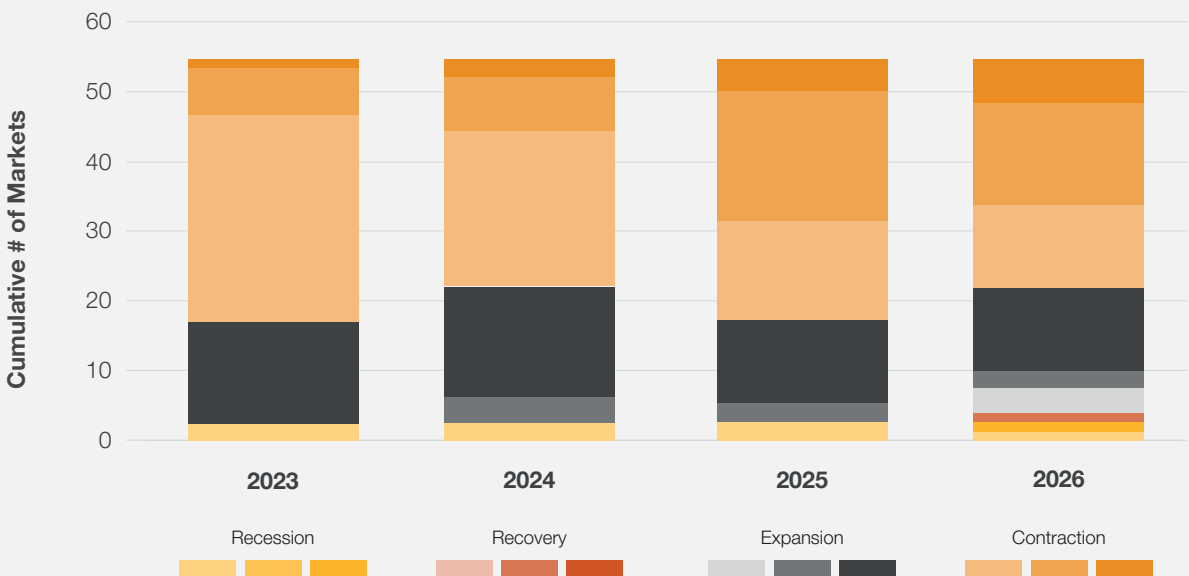
In the US industrial sector, the vacancy rate is forecasted to stay below its 20-year average; however, the sector slowed down as it approached mid-2023.

Retailers and wholesalers are exercising caution in light of economic uncertainties, temporarily halting inventory accumulation while US imports have been declining.

The contraction phase of the cycle will likely dominate this sector through 2026.

PwC Real Estate Barometer
US Industrial Markets - 2023 to 2026

Chart REB-3



Source: Data provided by CBRE, compiled and analyzed by PwC

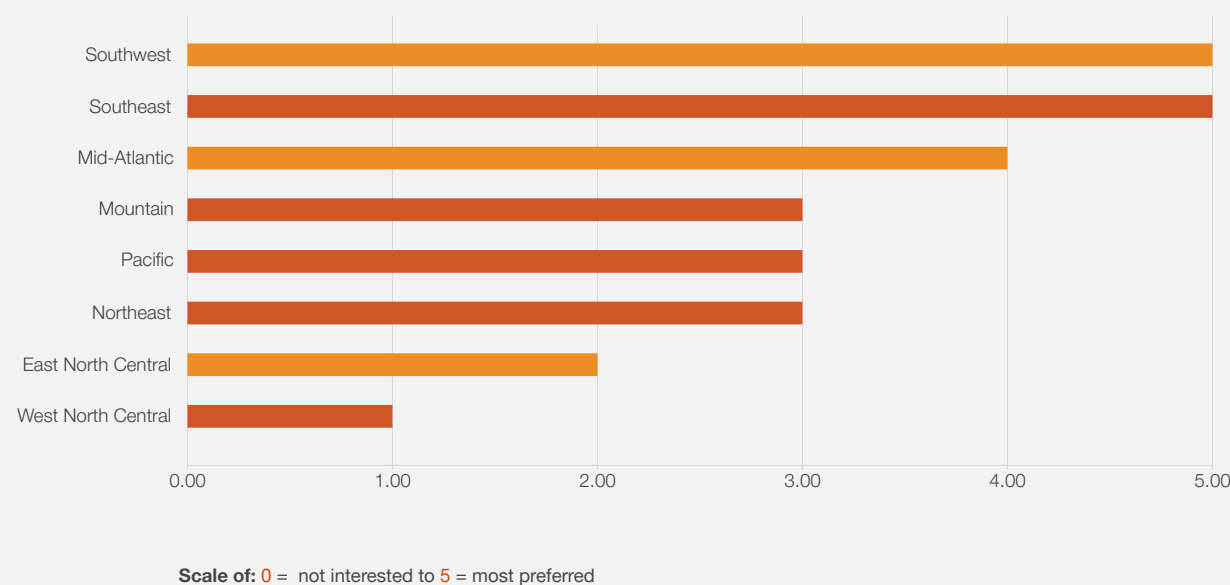
Special report:

Opportunity and challenges in industrial outdoor storage

Investor Survey is delighted to debut insights on outdoor storage in the industrial sector.

Global supply chains grabbed the national consciousness during the pandemic, as average consumers suddenly discovered empty shelves and extended delivery delays on online purchases. Critical pieces of national distribution networks and logistics operations are industrial outdoor storage (IOS) properties – land sites zoned for storing vehicles, construction equipment, building materials and shipping containers.

Regional Preference for IOS Acquisitions



Source: Survey conducted by PwC in May 2023

The industrial outdoor storage segment of the broader sector has gained popularity among investors in recent years. Estimates value the national IOS market at between \$100 billion and \$400 billion. IOS properties are in high demand.

This is particularly true in primary industrial markets and locations near coastal ports, logistics hubs, airports, rail yards and consumer population bases. It's driven by macroeconomic factors such as global trade, e-commerce adoption and global same-day delivery trends, direct-to-consumer growth and technological changes in the transportation sector.

Investor Survey looks forward to reporting on this niche sector in future data releases and updating investors on the important trends unique to this investment opportunity.



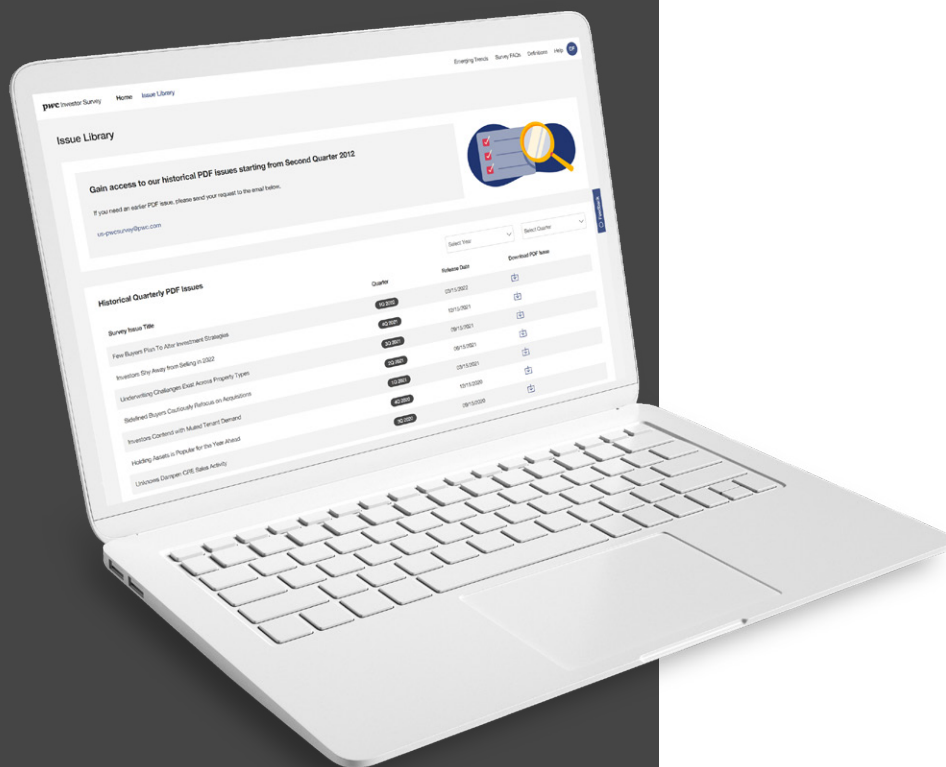
Stay ahead of the curve

With the ongoing challenges in the office sector and the changing real estate cycles across different markets and property types, you need access to quality data to help you make informed decisions.

Investor Survey provides valuable commercial real estate investment data and insights. The Q2 2023 report reveals how rising interest rates and other sector- and location-specific trends are shaping cap rates in the commercial real estate industry.

Keep your finger on the pulse of investment risk in commercial real estate.





Leveraging the powerful insights in Investor Survey gives you a competitive advantage in the commercial real estate landscape

Start a conversation with our team to learn more!

[Contact us](#)



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