



Mid-Atlantic Real Estate Sentiment Index | Spring 2017

In your (or your clients') opinion, how have the following changed in the *last three months*? How will the following change in the *next three months*?

- A. General Conditions for Real Estate: Better = 1, Same = 0, Worse = -1
- B. Commercial Rents: Higher = 1, Same = 0, Lower = -1
- C. Commercial Operating Expenses: Lower = 1, Same = 0, Higher = -1
- D. Cap Rates: Lower = 1, Same = 0, Higher = -1
- E. Credit Conditions: Better = 1, Same = 0, Worse = -1
- F. Your Gross Assets: Higher = 1, Same = 0, Lower = -1

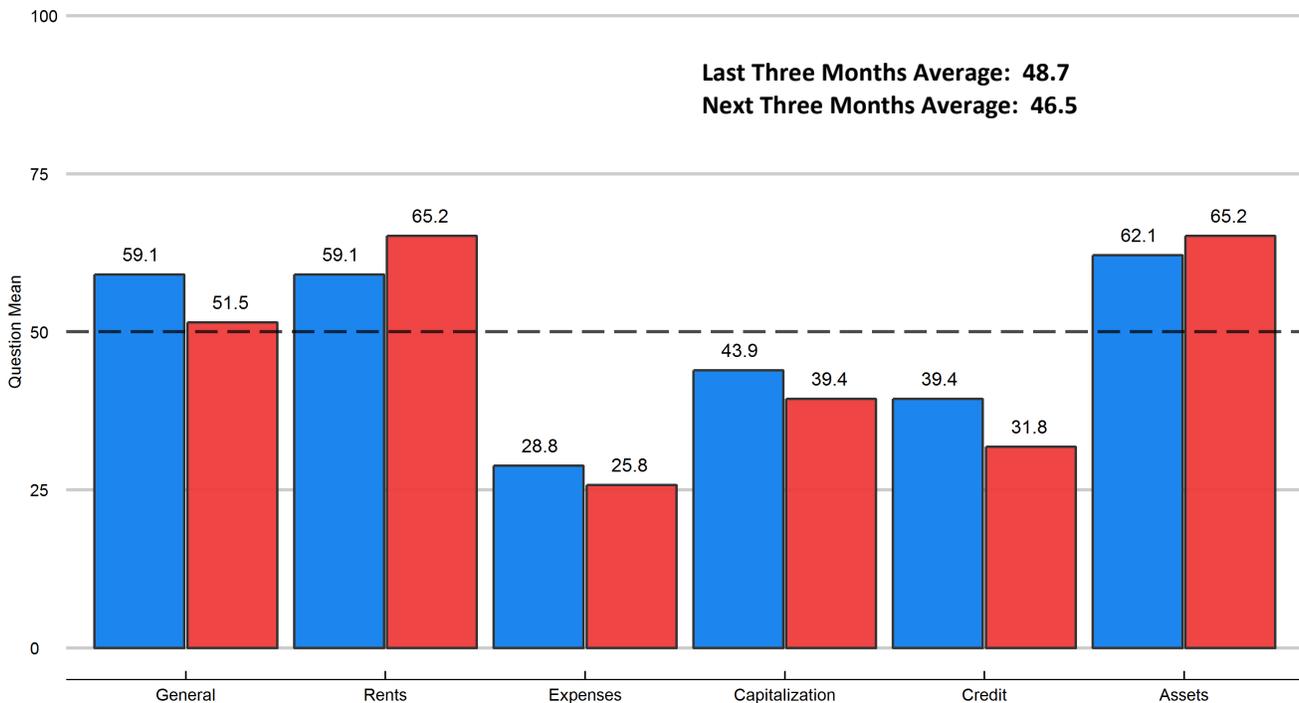
Explanation of the Mid-Atlantic Real Estate Sentiment Index

For each category and for the survey as a whole, respondents' answers (1, 0, or -1) for each question are summed and indexed as a function of the number of respondents, centered at 50, ranging from 0 to 100.

Therefore, index readings significantly higher than 50 indicate stronger agreement that conditions have improved or will improve. Readings significantly lower than 50 indicate stronger agreement that conditions have worsened or will worsen. Readings closer to 50 suggest agreement that conditions have stayed the same or will stay the same.

PREC Survey Response Summary Spring 2017

■ Last Three Months ■ Next Three Months

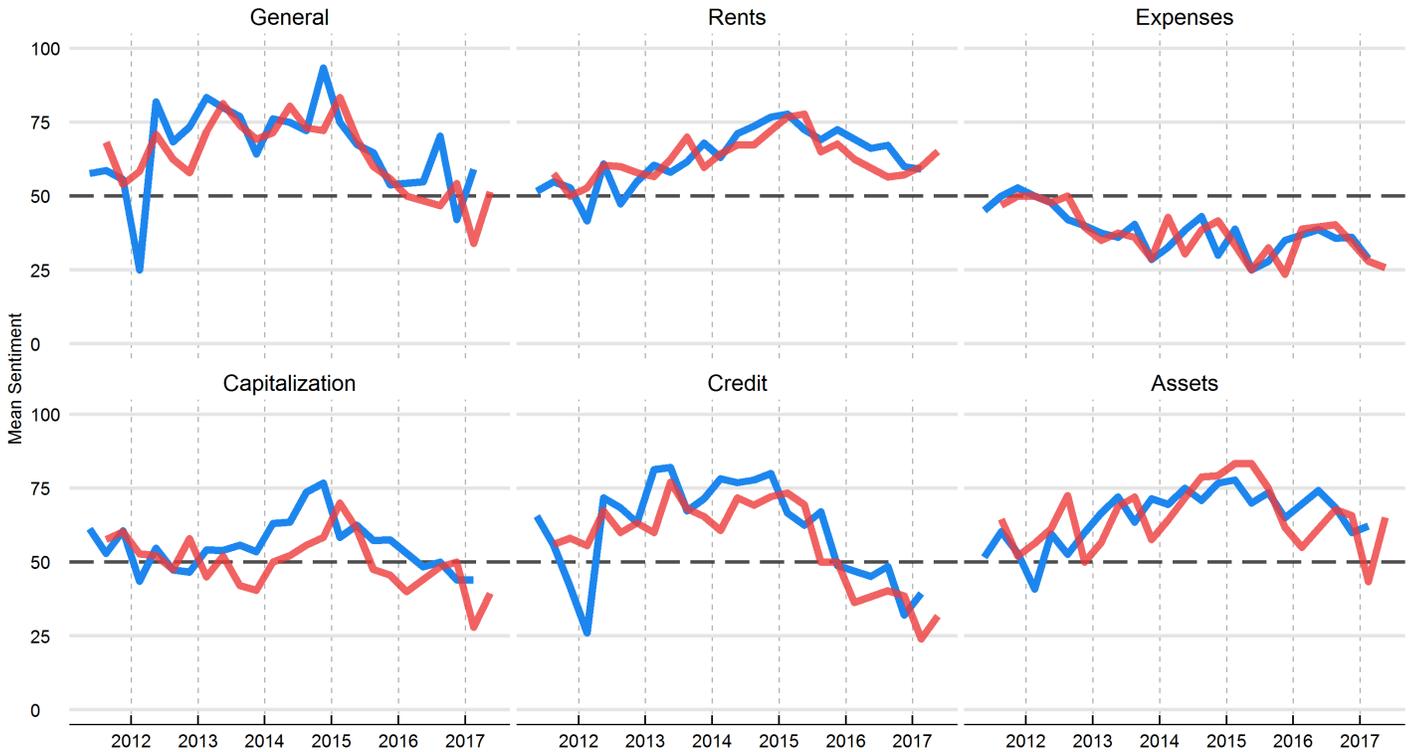


Time Series by Question Number | Spring 2011 — Spring 2017

Mid-Atlantic Real Estate Sentiment Index by Question Number

'Next Three Months' points are aligned to the quarter that they forecast.

— Last Three Months — Next Three Months



All Questions Experienced a Sharp Rebound in 2017 Q1

After the 2016 Q4 survey saw the lowest predictions in recent years, PREC members had more positive predictions for 2017. Every question saw a sharp uptick in sentiment, albeit still lower than the 2015 highs.

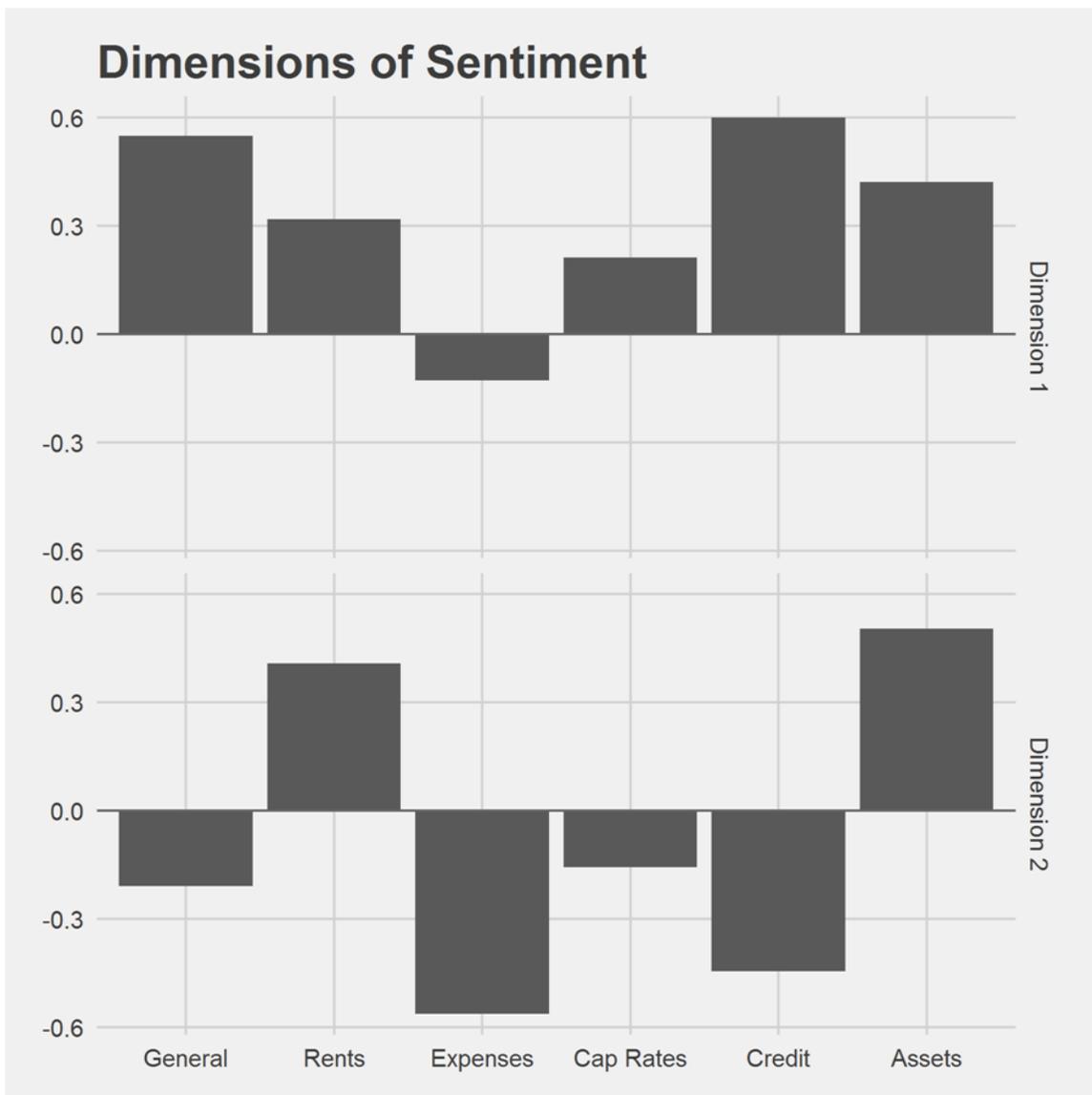
Time Series Raw Data and Key Market Indices

	December 7, 2016	February 15, 2017	% Change
PREC Survey Index Last Three Months	45.67	48.73	6.57%
PREC Survey Index Next Three Months	36.45	46.48	27.52%
10-year Treasury	2.34%	2.51%	
Dow Jones Industrial Average	19,549	20,504	

The Dimensions of PREC Sentiment

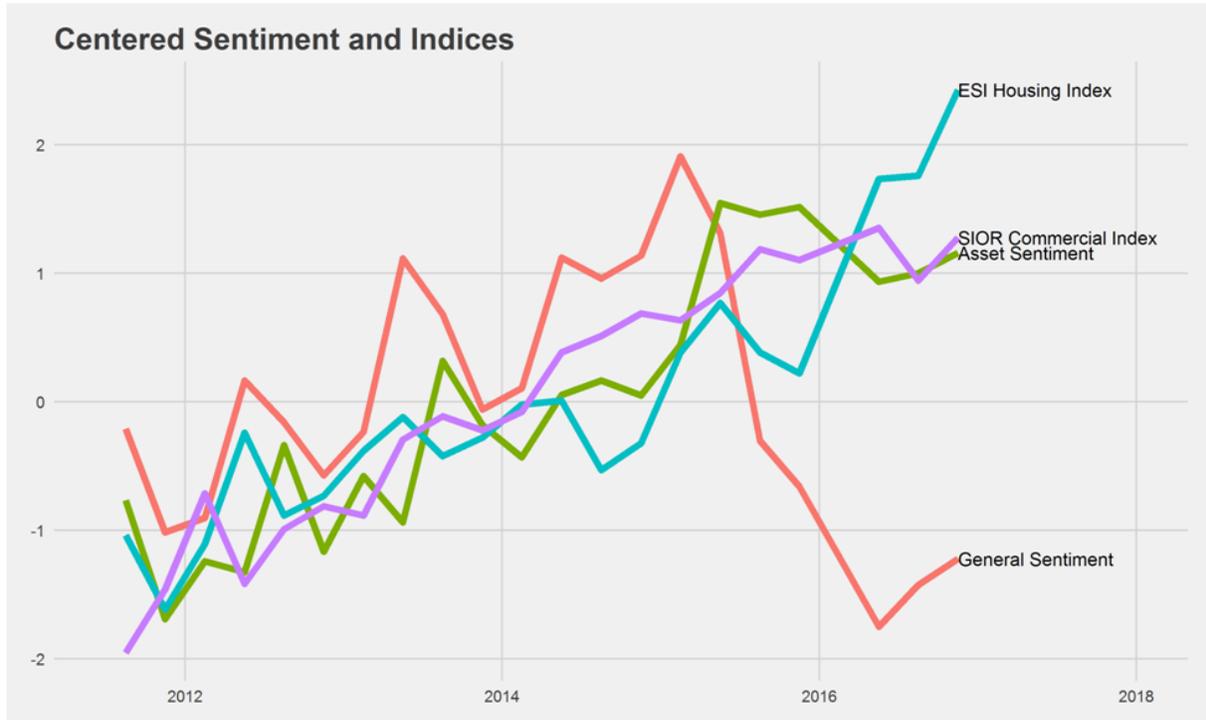
The Sentiment Index consists of six questions. However, there appear to be two dimensions to the sentiment; we can well-summarize the six questions using only two numbers. These dimensions are groups of questions that move together. The first dimension is the overall market sentiment: high values in this dimension correspond to positive values on General Conditions, Rents, Cap Rates, Credit, and Assets, and negative perspectives on Expenses. The second dimension captures the difference between financial market conditions and assets: positive values are associated with positive opinions on Assets and Rents, but negative opinions on General Conditions, Expenses, Cap Rates, and Credit. We can map each quarter to scores on these two dimensions.

The figure below shows the strength of each Question's score on a given dimension.



Sentiment Index Predictive Analysis | Spring 2011 — Spring 2017

We can then examine the relationship between these Sentiment Dimensions and market indicators. For this analysis, we bring in ESI's Philadelphia Housing Index, an index of residential home values, and the Society of Industrial and Office Realtors' Mid-Atlantic Commercial Index. (Dimension 1 has been named "General Sentiment", Dimension 2 "Asset Sentiment").



In the years since 2011, both Residential and Commercial properties have steadily increased. The growth in Residential prices has boomed especially over the last year. The PREC Sentiment Index has been more varied. In mid 2015, the General Sentiment plummeted, creating a gap between sentiment and prices that we had not before experienced. The PREC Asset Sentiment has remained largely positive, indicating that members' opinions on Assets remain more positive than financial conditions.

Historically, changes in the General Sentiment have weakly predicted changes in Residential and Commercial markets. The fact that the Centered General Sentiment has increased by 0.22 over the last Quarter predicts that the ESI Philadelphia Housing Index would increase by +1.3% over the next quarter, though we have a lower level of General Sentiment than any we've seen since 2011.

Sector Insights

This index represents industry sentiment toward the Mid-Atlantic real estate market at the beginning of Spring 2017. As we mentioned in our previous report, the index has been experiencing ongoing inconsistencies and turbulence in sentiment. It remains difficult to pinpoint exact causes for the uptick in positive sentiment after such a deep decline in Winter 2016-2017, however, we speculated the following factors in our last report which may have added to the on-going turbulence: fear of recession and a

Results and Analysis: **Spring 2017**

slow of supply, rate hikes, low issuance of CMBS with tightening of lending standards, as well as economic and political uncertainty.

In the three months leading up to this sentiment survey, we have seen a number of trends influence commercial real estate at both the local and national level:

- **Expensive Construction Costs:** Sectors like Multifamily have been experiencing extremely high construction costs in the Mid-Atlantic region. Additionally, construction lending continues to be difficult to secure.
- **The New Administration & Deregulation:** The commercial real estate industry at large believes that the Trump Administration will have a positive impact on the industry due to the Administration's stance on deregulation and the potential for tax reform. Many also believe Trump will follow through on his promise to dismantle the Dodd-Frank Act.
- **Positive Outlook for U.S. Economy met with Uncertainty:** Although the political climate and change in administration has caused concern and uncertainty for some, many are optimistic about market opportunities brought on by a strong economy. However, this optimism is also met with uncertainty regarding potential rate hikes.
- **Foreign Capital:** The commercial real estate industry saw a large presence of foreign capital over the past year. However, many are fearful that foreign investors may start to back away from the U.S. market should the Administration enact such anti-trade and restrictive travel policies.

As stated above, there is no single explanation for the drastic turbulence in industry sentiment over the past few months. Though there is still uncertainty, real estate fundamentals in the Mid-Atlantic and beyond remain stable and it is clear that PREC members are noticing this.

- **Tatiana Swedek**, Associate Director of Communication, PREC &
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