

# Macroeconomic trends: impact on real estate and the future workplace

April 12, 2022



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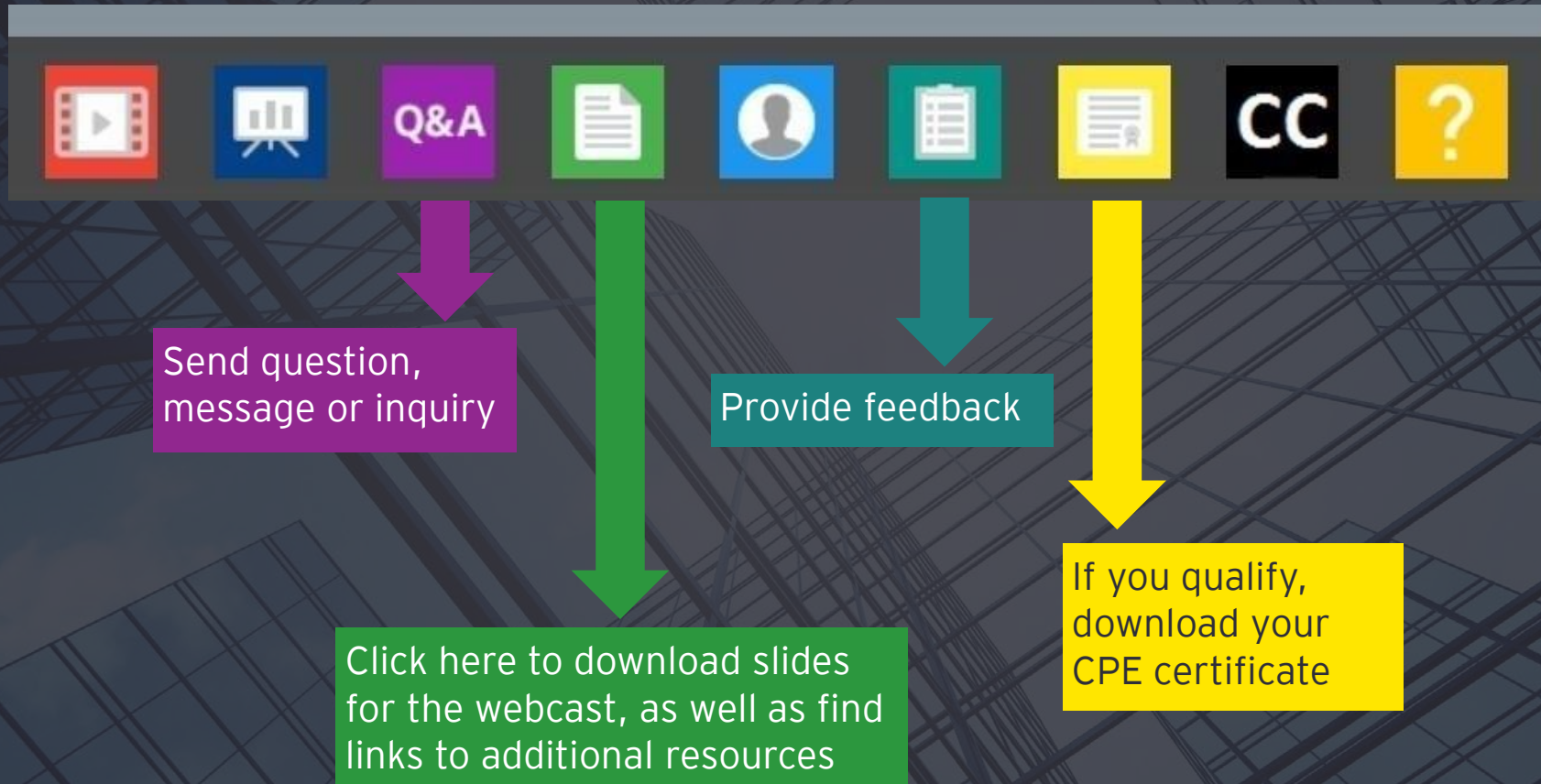
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# CPE objectives

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- ▶ Recognize the impact of macroeconomic trends on various real estate property types
- ▶ Review the impact of inflation and interest rates on valuation, pricing and the M&A outlook
- ▶ Discuss How to reimagine the office footprint and experience in response to hybrid working models
- ▶ Examine which sectors may be at greatest risk for turnover and how landlords can better identify where the risk may be in tenant portfolios

# Housekeeping items



If you experience technical difficulty, please hit Ctrl plus F5 to refresh, or send us a message using the Q&A button.

# Today's speakers



**Chris Johnston**  
EY Americas REIT Leader  
Ernst & Young LLP



**Christine Tutaj**  
Senior Manager  
Strategy and Transactions  
Ernst & Young LLP



**DeJeana Chappell**  
Senior Manager  
Workplace Strategy  
Ernst & Young LLP



**Gregory Daco**  
Chief Economist  
EY-Parthenon  
Ernst & Young LLP



**Dirk Aulabaugh**  
Executive Vice President and  
Global Head of Advisory Services  
Green Street Advisors



**Brett M. Johnson**  
EY Americas Real Estate  
Strategy and Transactions  
Leader  
Ernst & Young LLP



**Jeanee Hoppe**  
Director, Organization  
Solutions  
3M



**Grace Paul**  
Experience Leader  
Real Estate Services  
Ernst & Young LLP

# Today's agenda

Macroeconomic overview

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Real estate sector update

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Industry impacts

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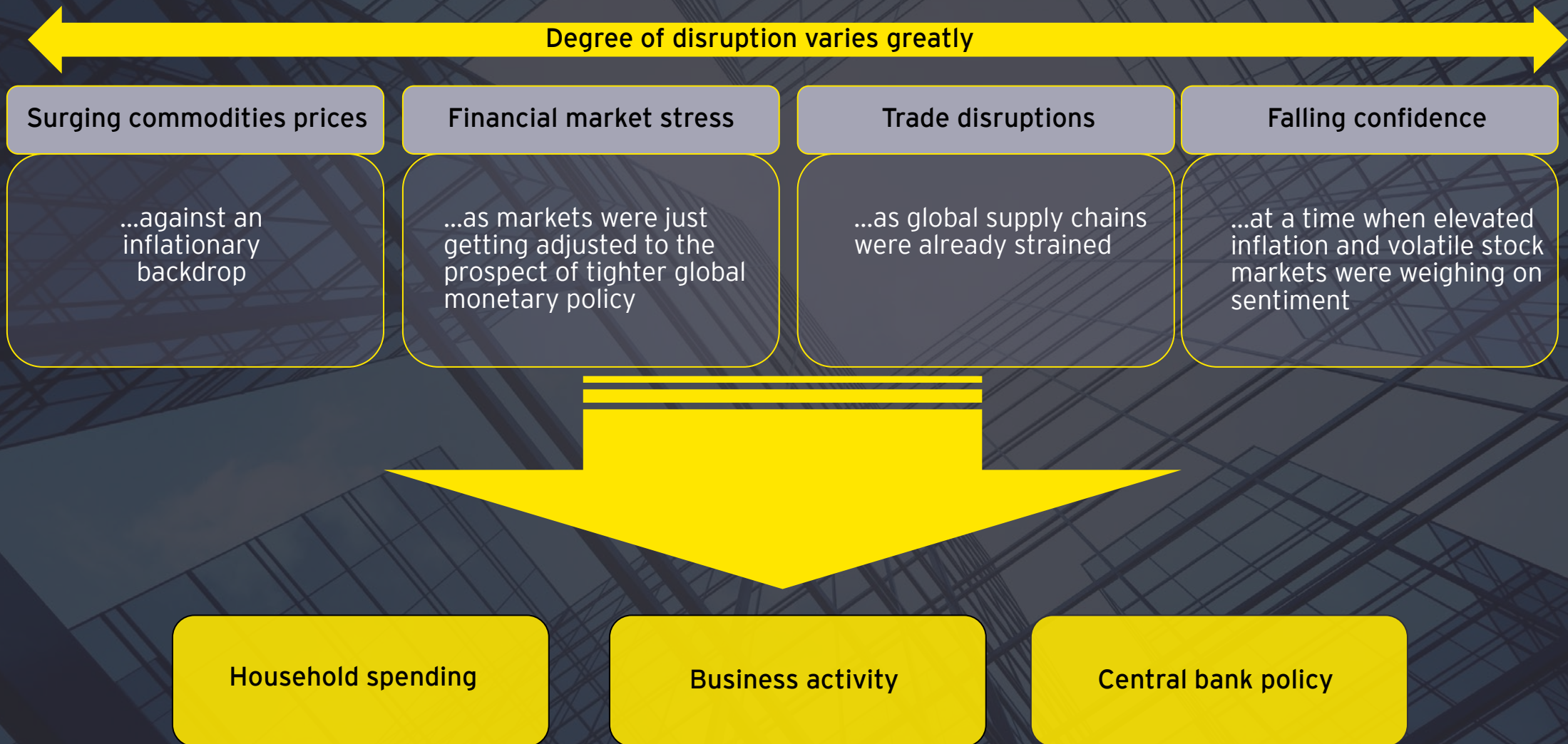
The future workplace experience

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# 1

## Macroeconomic overview

# The war in Ukraine will constrain, but not derail, the global economic recovery





# US economic fundamentals were strong heading into the war

Should provide some insulation against the drag from higher commodities prices and tighter financial conditions

## ~3.5% GDP growth (2022 forecast)

- ▶ Robust, but cooling, consumption
- ▶ Resilient business capex
- ▶ Cooler housing activity
- ▶ Softer fiscal tailwind
- ▶ Headwinds from the war in Ukraine

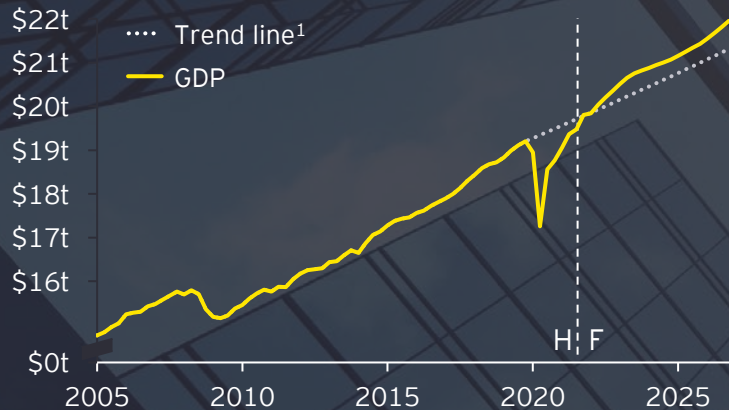
## ~3.3% unemployment rate (Q4 2022 forecast)

- ▶ Strong labor market recovery
- ▶ Unemployment rate falling below pre-COVID-19 level in second half 2022
- ▶ Rebounding labor force participation
- ▶ Strong wage growth, but cooling in second half

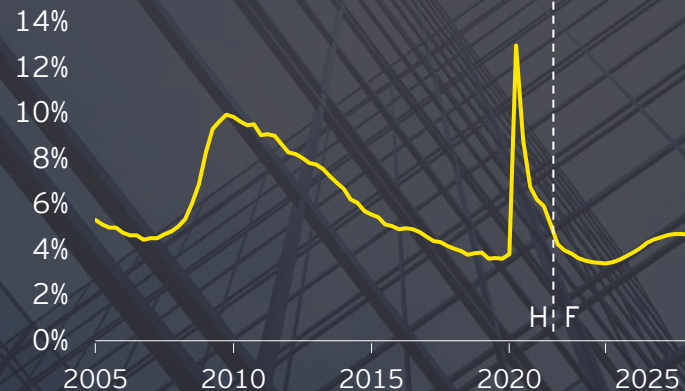
## ~5.5% year-over-year Consumer Price Index (CPI) inflation (Q4 2022 forecast)

- ▶ Persistently lifted by commodities price surge
- ▶ Some downward pressure from:
  - Cooler consumer spending growth
  - Rotation in spending mix toward services
  - Easing supply constraints

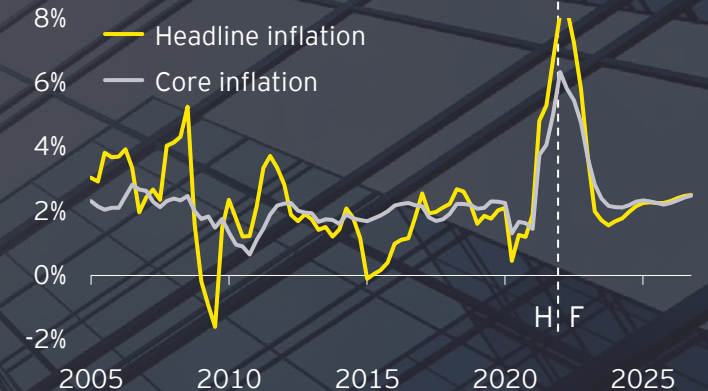
## US real GDP<sup>1</sup> (2005-26F<sup>2</sup>)



## Unemployment rate (2005-26F)



## Year-over-year % change in CPI (2005-26F)



**Key risks: COVID-19 pandemic, geopolitical tensions, inflation, supply constraints, excessive Fed tightening**

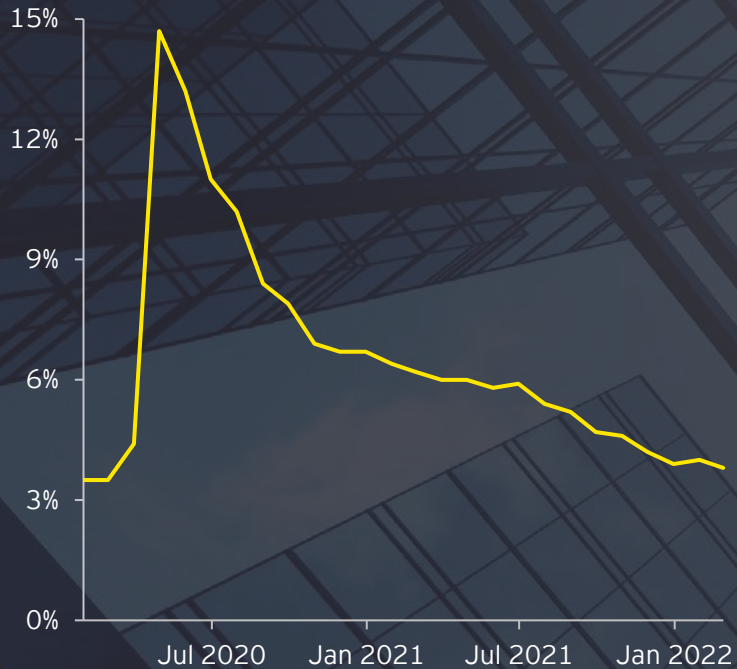
Sources: EY-Parthenon analysis; EY-Parthenon Macroeconomic Model.

<sup>1</sup> Pre-COVID-19 trend line illustrates extrapolation of the Q4 2019 trend through Q4 2026.

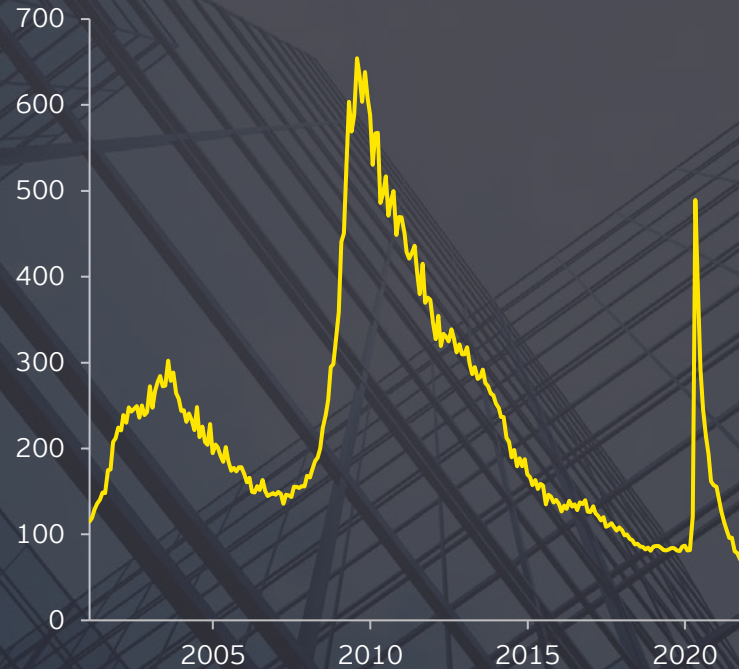
<sup>2</sup> Shows graphs and all subsequent graphs seasonally adjusted, unless otherwise indicated.

# Extremely tight US labor market with demand far outstripping supply

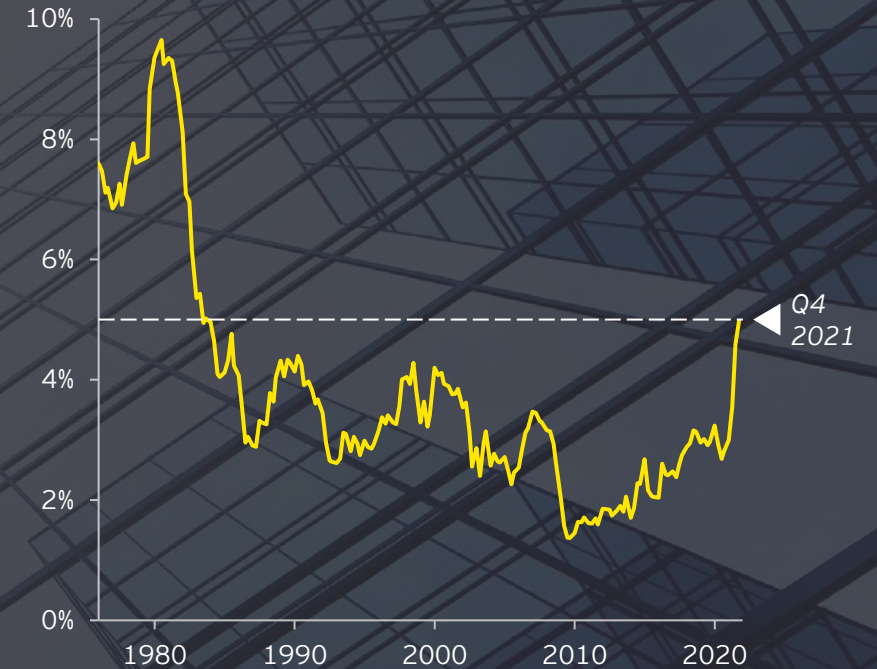
Unemployment rate<sup>3</sup>  
(January 2020-February 2022)



Unemployed persons per job opening  
(December 2000-January 2022)



Year-over-year % change in employment cost index for private wages and salaries  
(Q1 1976-Q4 2021)



Source: Bureau of Labor Statistics; EY-Parthenon Macroeconomic Model; EY-Parthenon analysis.

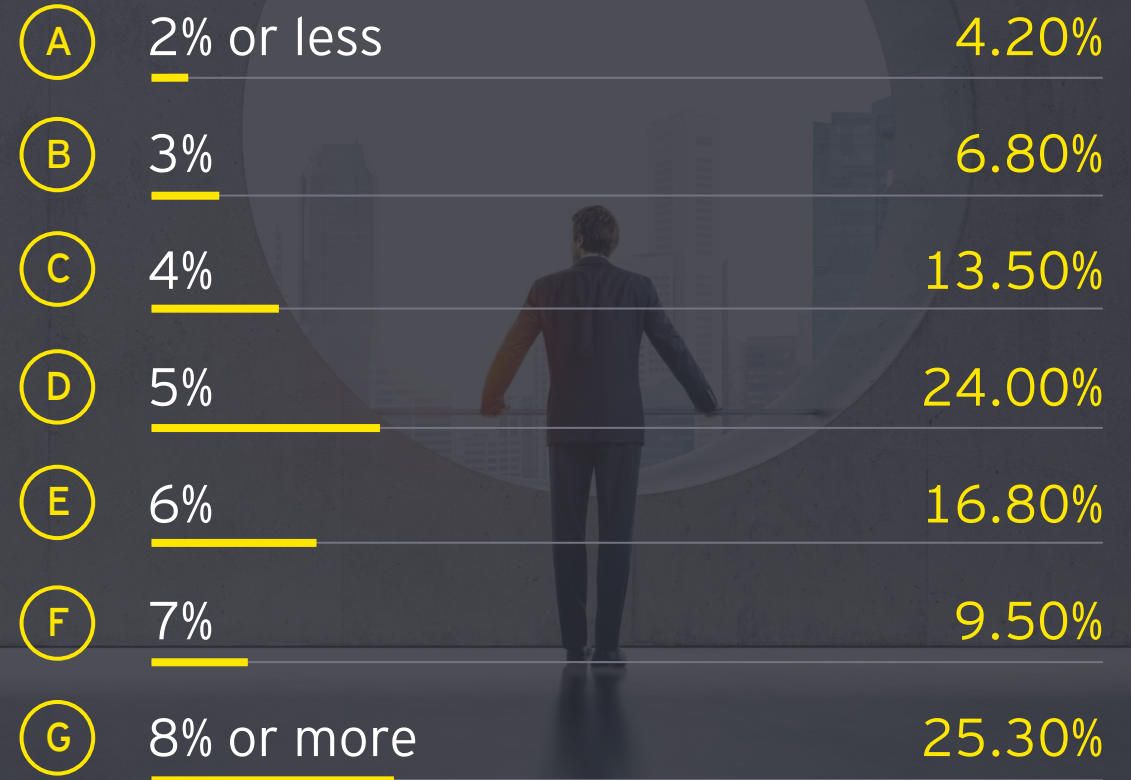
<sup>3</sup> The month-over-month change in the total nonfarm employment data comes from the Bureau of Labor Statistics Establishment Survey. The unemployment rate data comes from the Bureau of Labor Statistics Household Survey.

\* The December 2021 and January 2022 data is preliminary.

# Polling question – Result

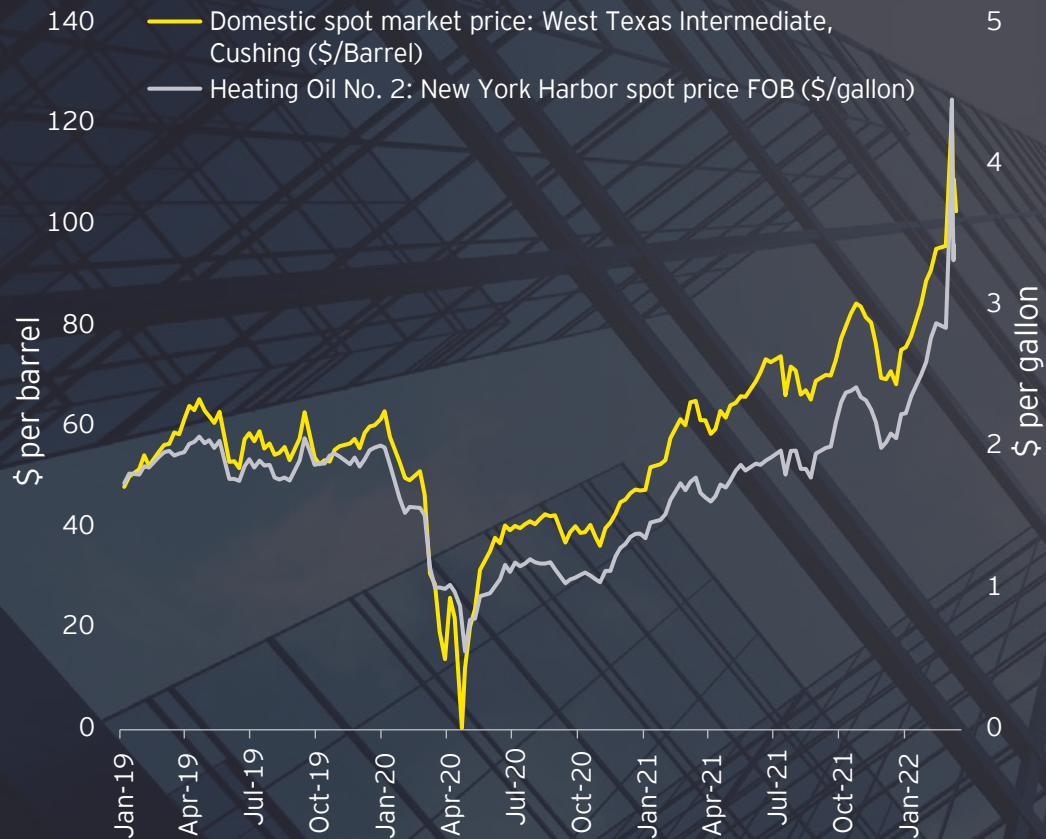


CPI inflation reached 7.9% year over year in February – a 40-year high. Where do you see inflation 12 months from today?

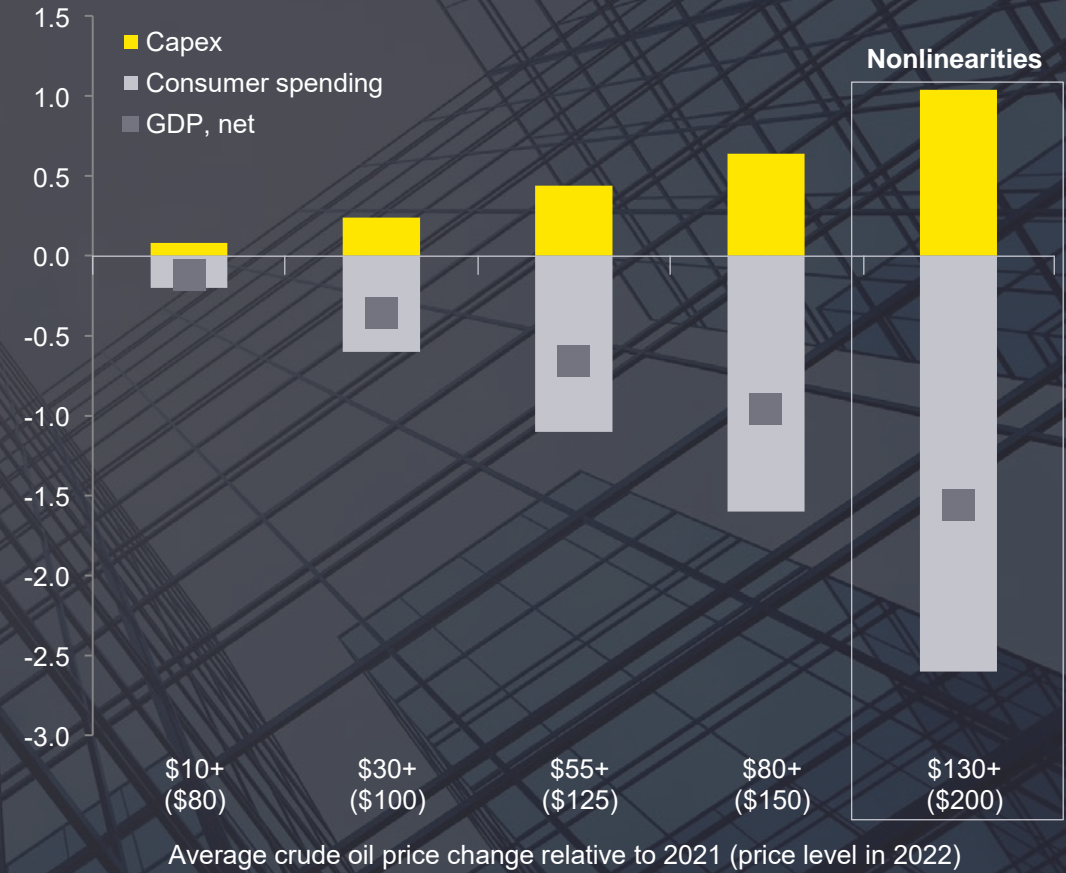


# Risks to US businesses and consumers due to higher energy prices

**West Texas Intermediate crude and heating oil price**  
(January 2019-March 2022)



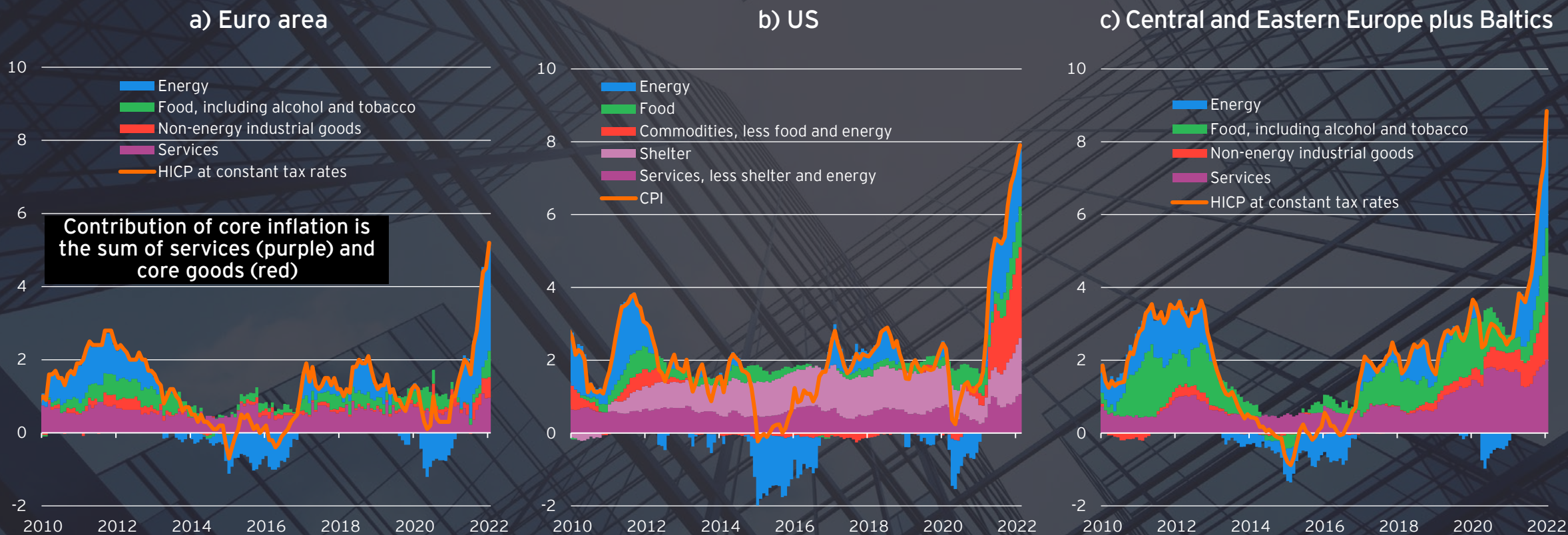
**Significant oil drag** (contributions to GDP growth, ppt)



Source: EY-Parthenon Analytics based on publicly available information.

# Inflation in the euro area is driven predominantly by energy prices In contrast to the US and Central and Eastern Europe, where price pressures are more broad-based

## Statistical decomposition of year-over-year inflation (in percentage)



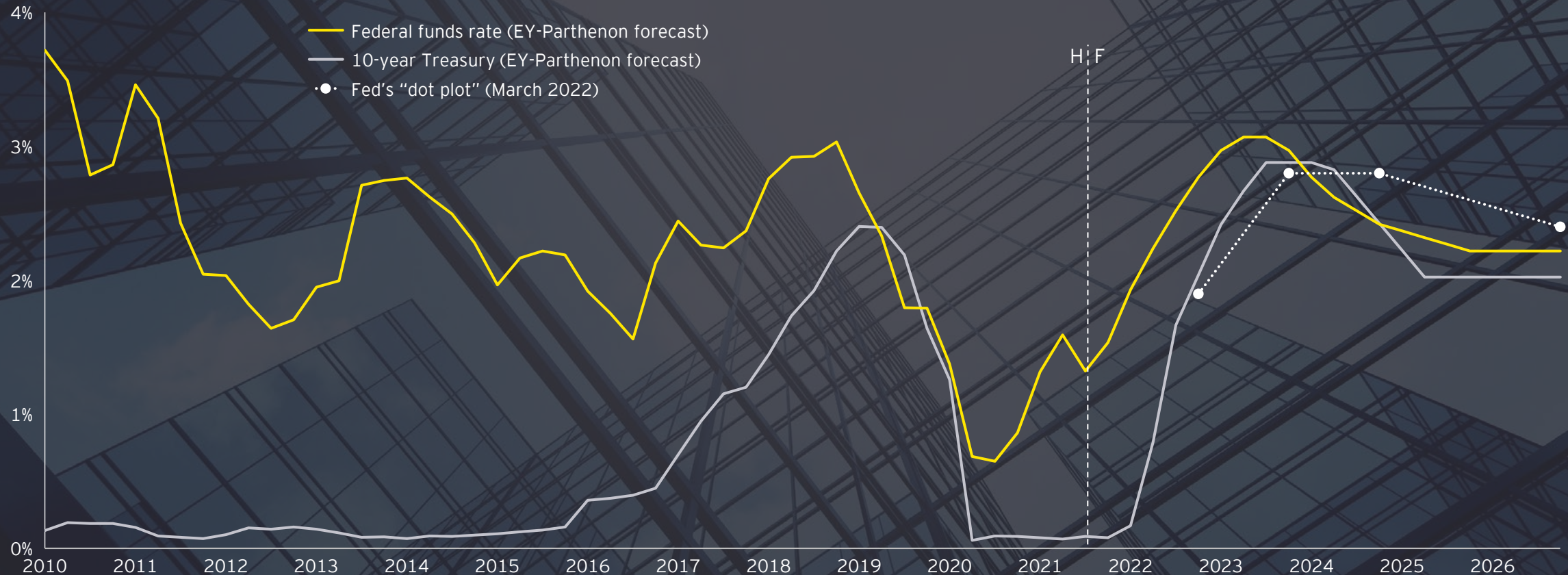
Sources: Eurostat; FRED; Bureau of Labor Statistics; EY-Parthenon Macroeconomic Model; EY-Parthenon analysis.

Central and Eastern Europe plus the Baltics includes Poland, Czechia, Slovakia, Hungary, Romania, Lithuania, Latvia and Estonia. Weighted averages are provided.

# The Fed is committed to fighting inflation By aggressively raising rates and reducing the size of its balance sheet

We anticipate 175 bp to 200 bp of front-loaded tightening in 2022.

EY-Parthenon interest rate forecasts, federal funds rate and 10-year Treasury yields (2010-26F)



Source: EY-Parthenon Macroeconomic model

# 2

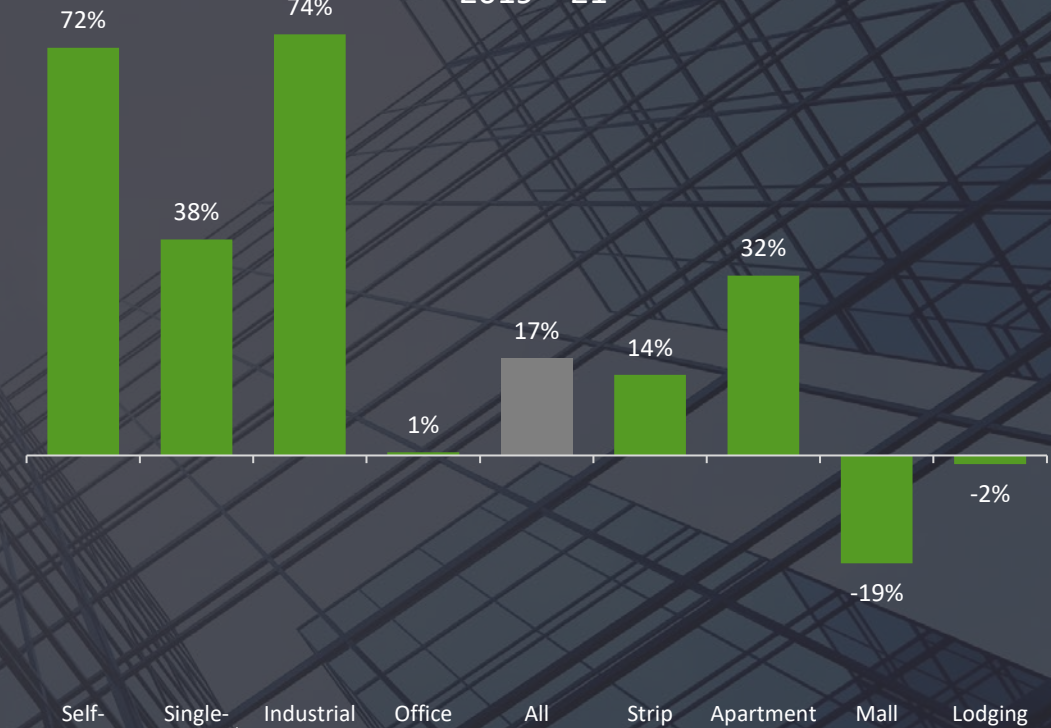
## Real estate sector update

# Trailing three-year NOI growth and impact on pricing

Annualized NOI income growth  
2019 – 21



Property price appreciation  
2019 – 21

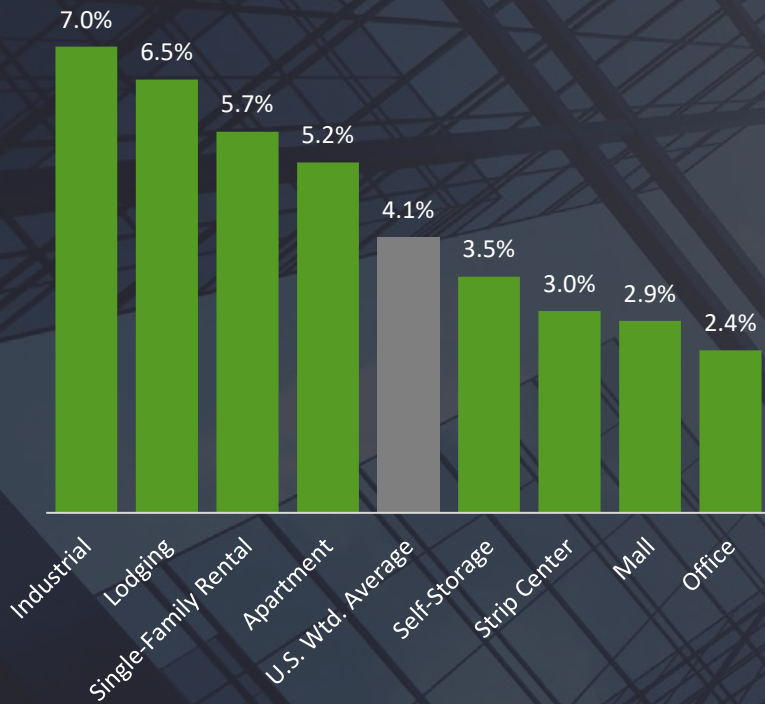


\* Calculated using S&P and Case-Shiller Index.  
Source: Green Street

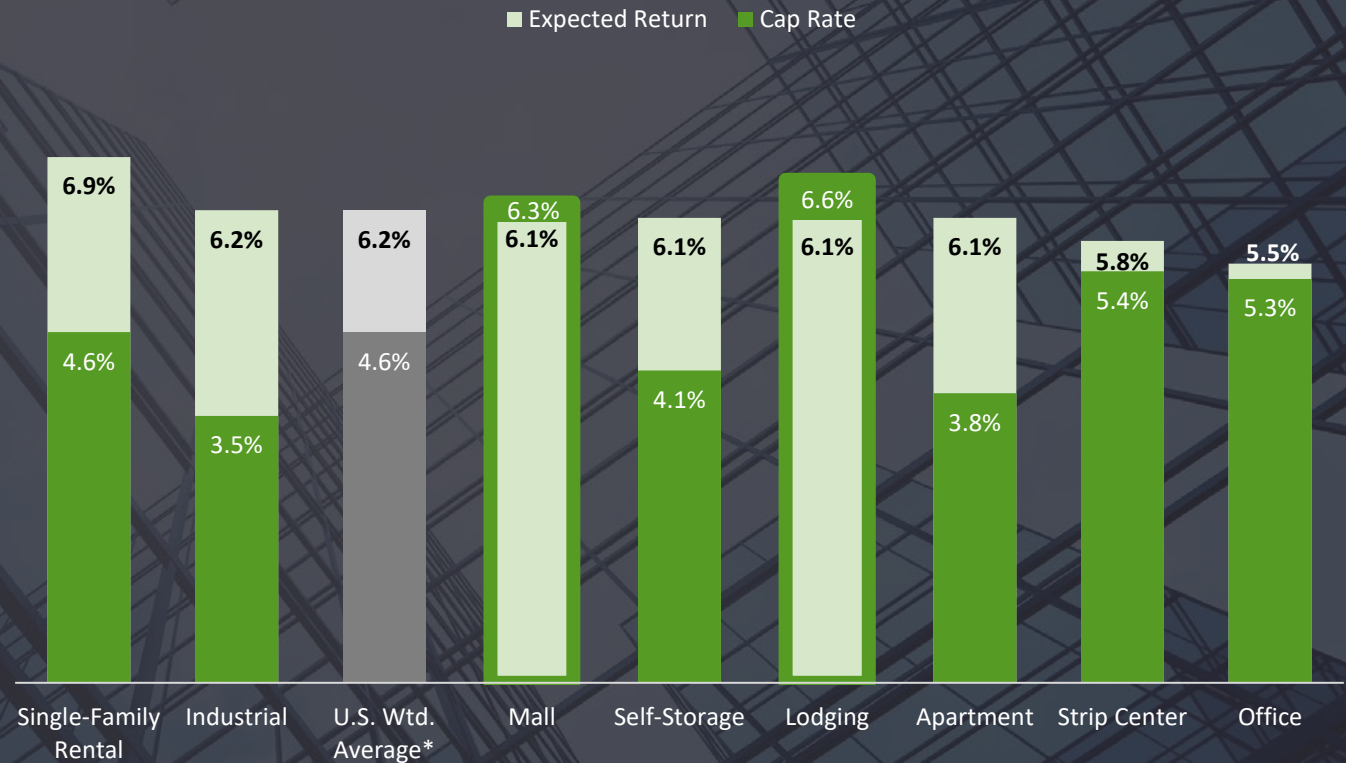


# Forecasted NOI growth and expected returns

Near-Term net operating income growth estimates  
2023E – 26E



Expected returns and nominal cap rates by sector

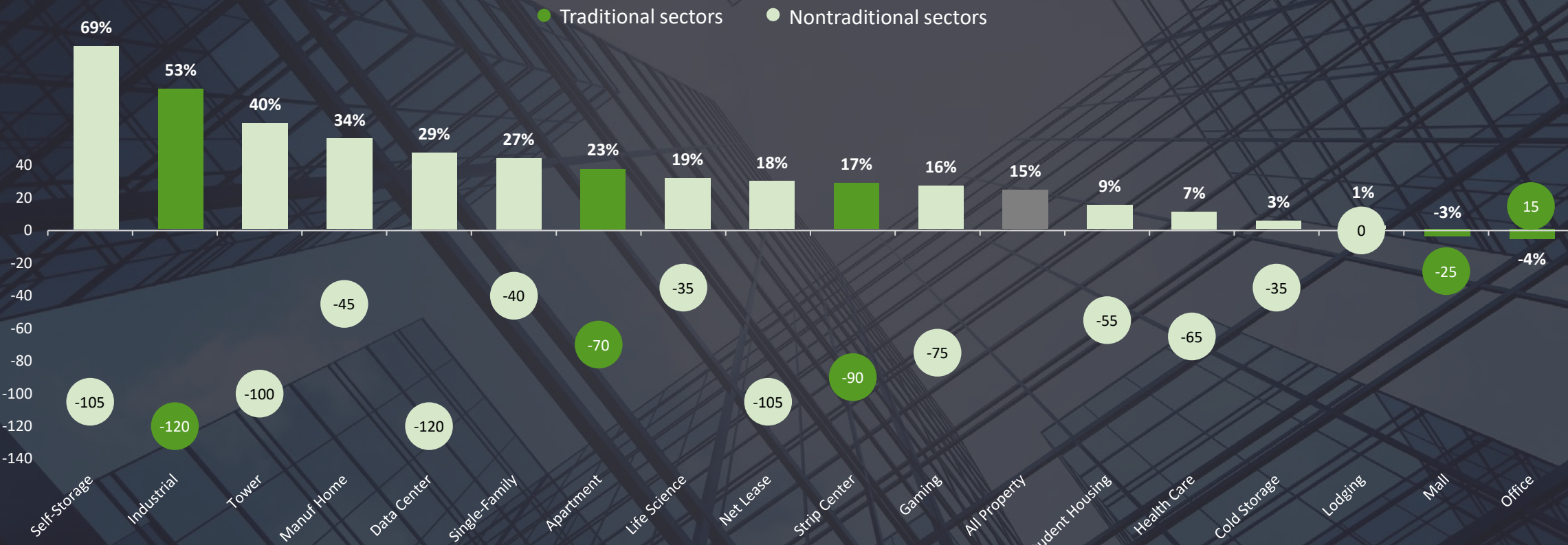


\* Includes other nontraditional sectors not shown.

Source: Green Street

# COVID-19 impact on traditional vs. nontraditional sectors

Private market property prices and cap rate changes (bps) vs. pre-COVID-19



Source: Green Street



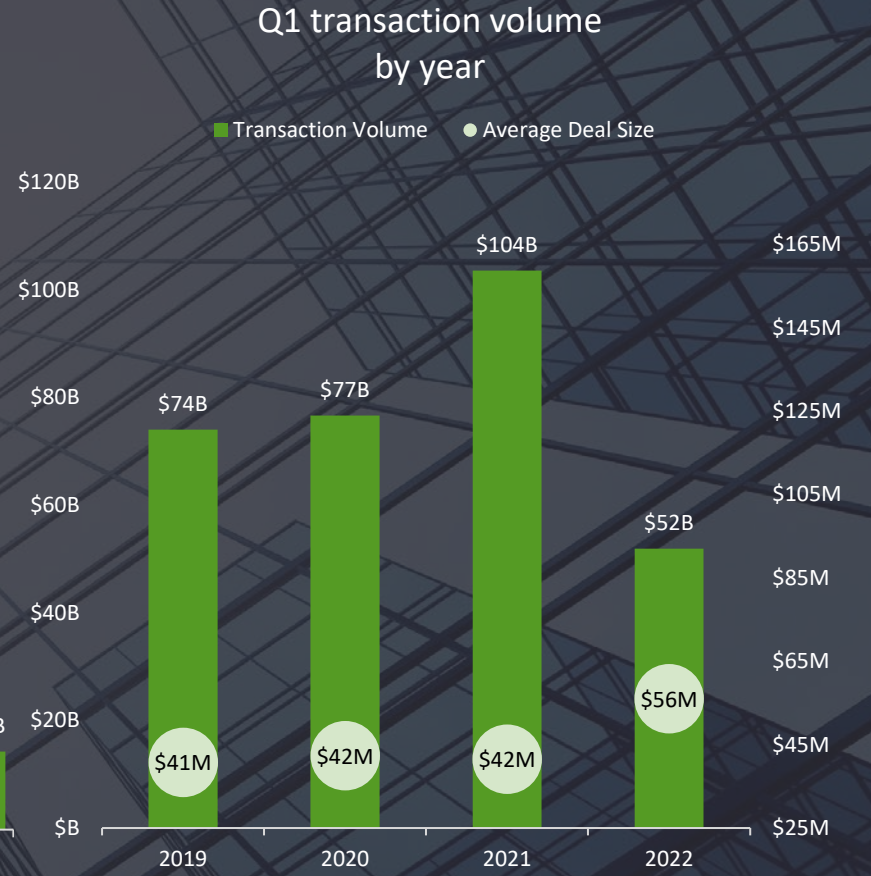
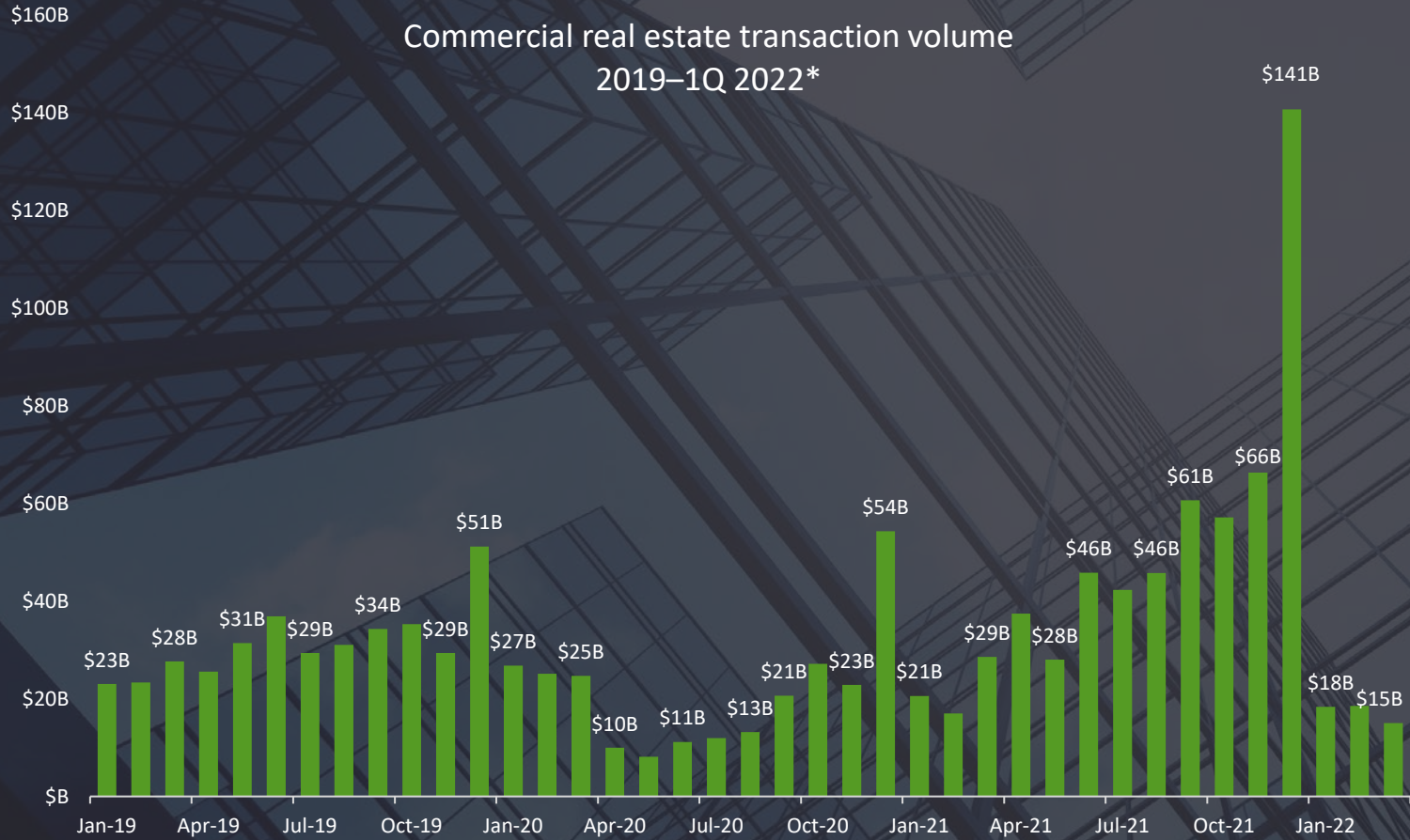
# Polling question – Result



In 2022, is your organization more likely to acquire:

<b>A</b>	<u>Traditional assets</u>	26.90%
<b>B</b>	<u>Non-traditional assets</u>	13.70%
<b>C</b>	<u>Both</u>	29.20%
<b>D</b>	<u>Neither</u>	30.20%

# Observed transaction activity

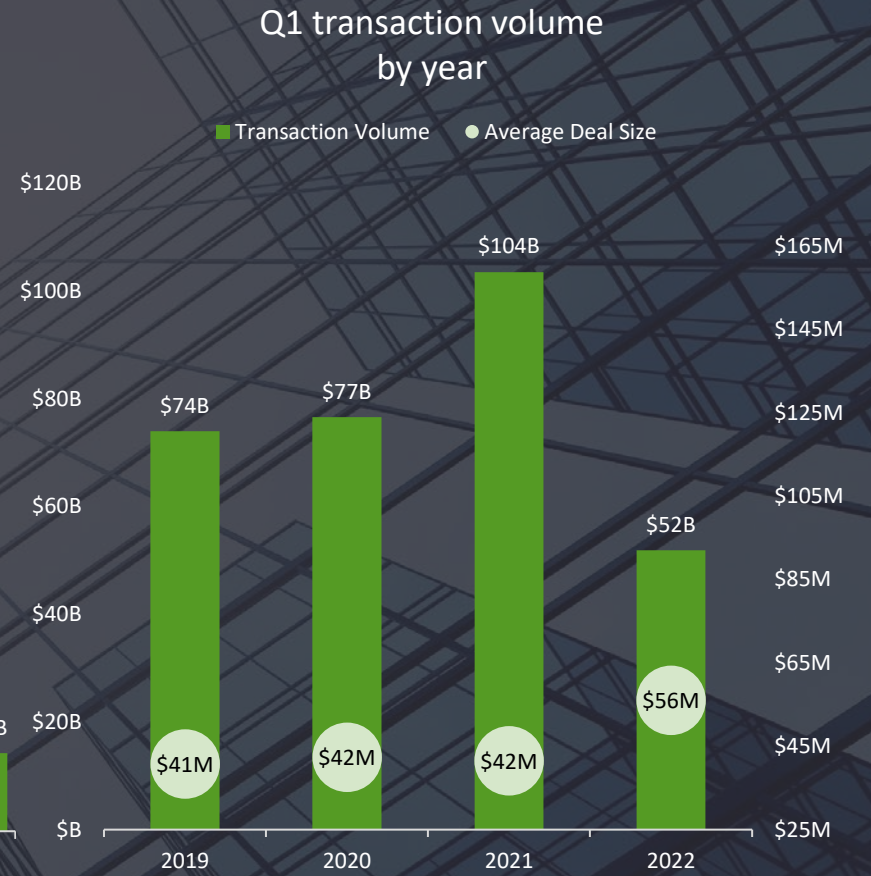
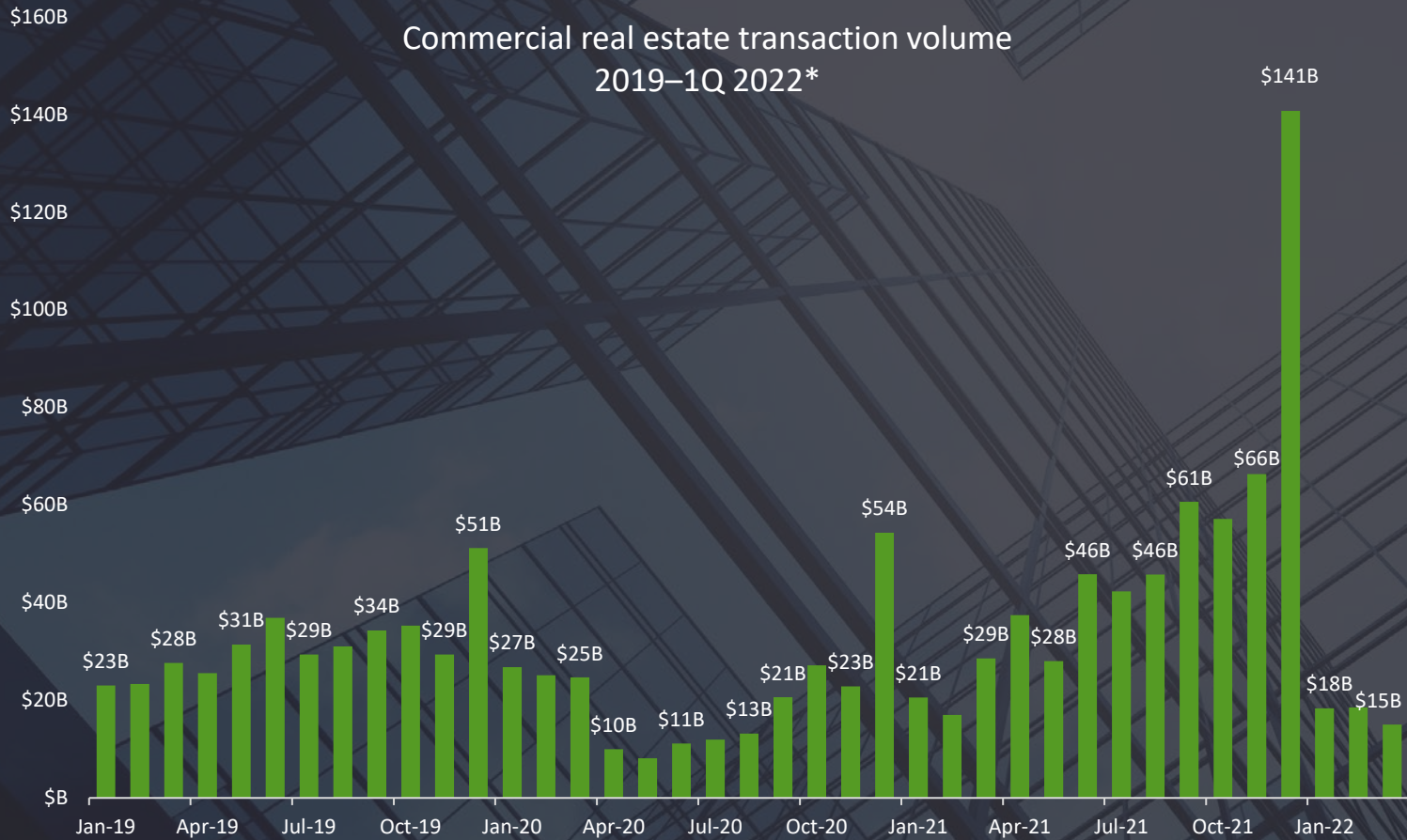


\* As of March 28, 2022.  
Source: Green Street

# 3

## Industry impacts

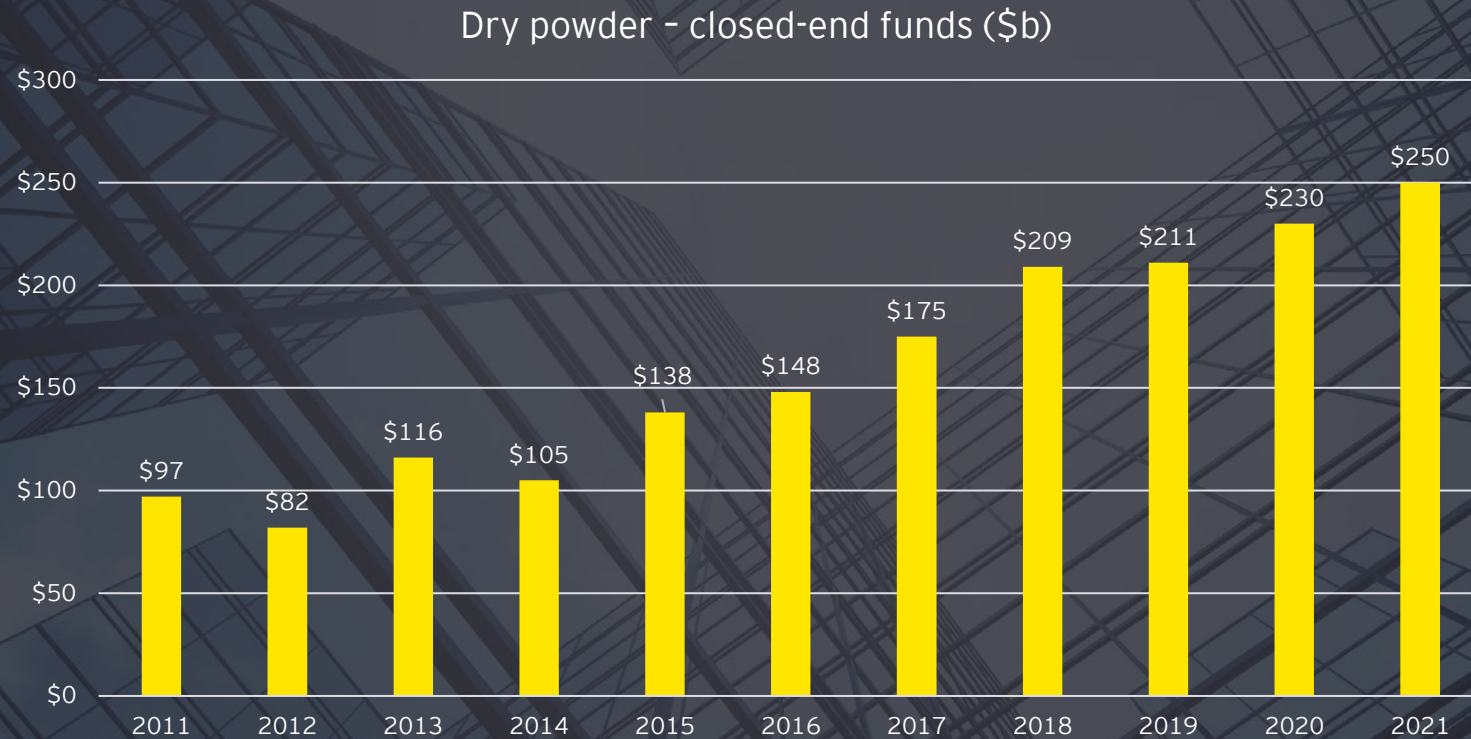
# Observed transaction activity



\* As of March 28, 2022.

Source: Green Street

# 2021 saw record amounts of dry powder, at \$250b as of 4Q 2021



Source: Capital Markets Report, Newmark Research, 4Q 2021. North American-focused real estate funds

# Polling question – Result



What is your prediction for the overall transaction volume in 2022 compared with the 2021 activity?

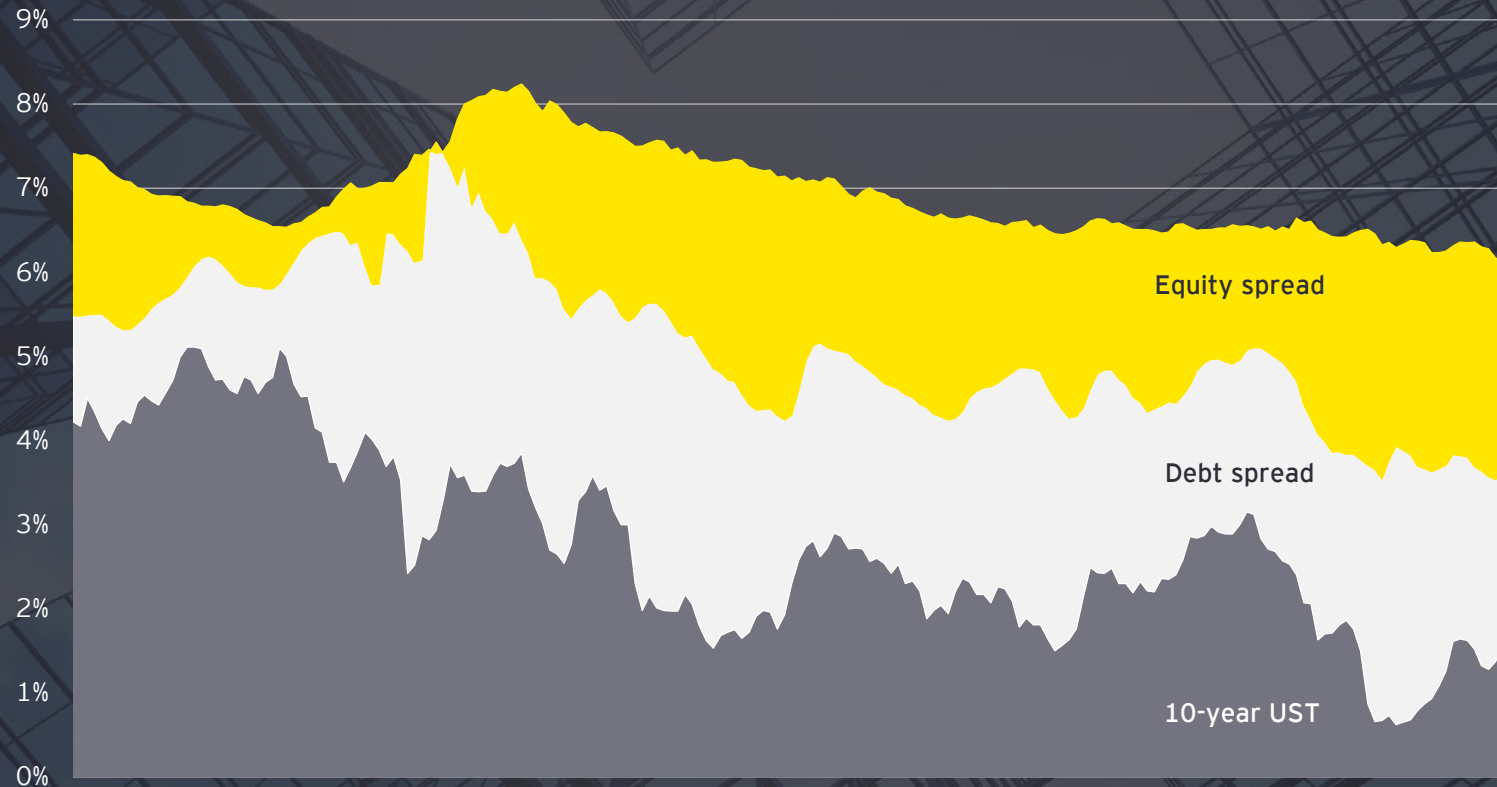
<b>A</b>	<u>Substantially less than 2021 volume</u>	13.20%
<b>B</b>	<u>Slightly less than 2021 volume</u>	31.30%
<b>C</b>	<u>Near 2021 volume</u>	25.10%
<b>D</b>	<u>Slightly greater than 2021 volume</u>	23.40%
<b>E</b>	<u>Substantially greater than 2021 volume</u>	6.90%



# Cap rates and interest rates don't have a one-to-one relationship

Investors may accept lower spreads, depending on other risk factors

Composition of commercial cap rates

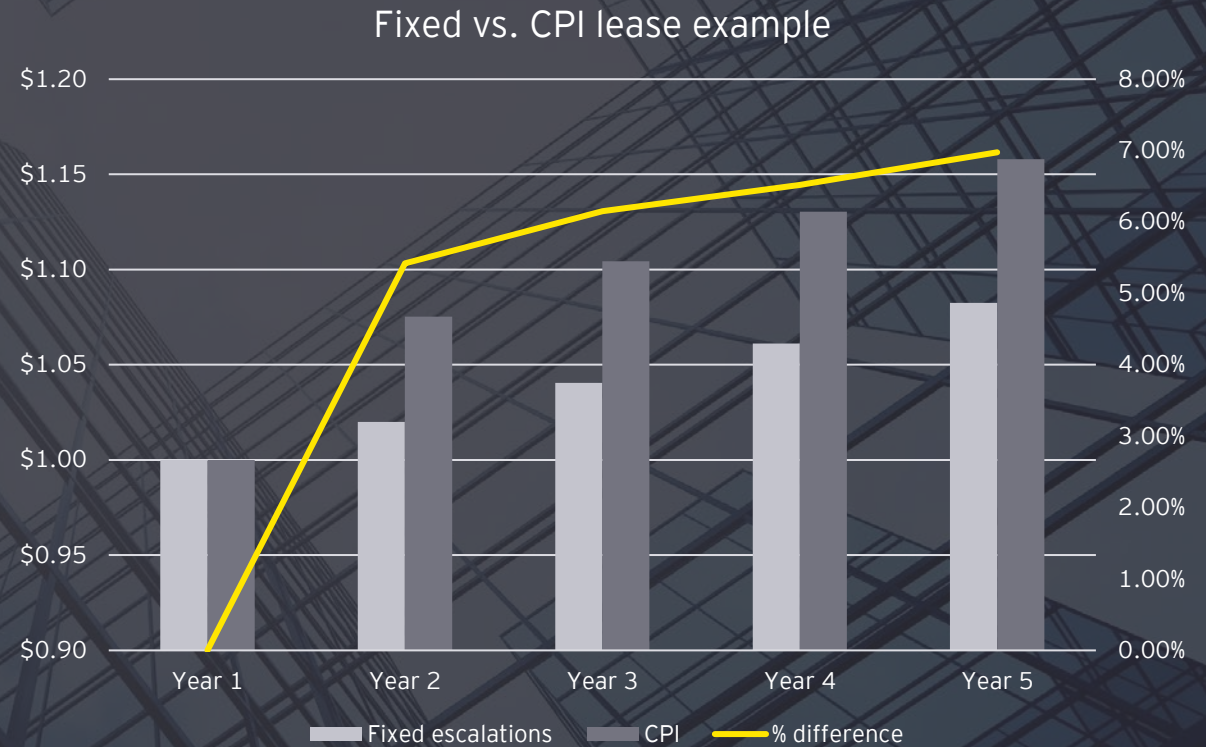


Source: "Capital Trends US Big Picture," *Real Capital Analytics*, February 2022.

# Landlords are rethinking lease escalation strategy

Example: two leases commencing January 1, 2021:

- ▶ Lease 1: escalations fixed at 2%
- ▶ Lease 2: escalations tied to CPI



Source: CPI, all items, U.S. Bureau of Labor Statistics, February 2022; EY Parthenon Macroeconomic Model  
Lease 2 escalations: 2022 - 7.53%, 2023 - 2.71%, 2024 - 2.35%, 2025 - 2.44%

# 4

## The future workplace experience

# Work Your Way



“

We are aiming to deliver both a superlative employee experience and business performance. It is about getting your work done and delivering results. Not about where you sit and what time you logged on.

- Aman Gupta, Portfolio Strategy and Transformation  
3M

- ▶ 3M, with headquarters in Minnesota, is changing how and where employees work.
- ▶ Launched in August 2021, *Work Your Way* is 3M's plan to provide employees with choice and an enhanced work-life balance.
- ▶ The new plan will impact the majority of its 90,000 people who are part of the non-production workforce.
- ▶ *Work Your Way* is an expansion of 3M's flexible work model and incorporates learning from the pandemic with roots founded in trust and a virtual-first mindset.

# Polling question – Result

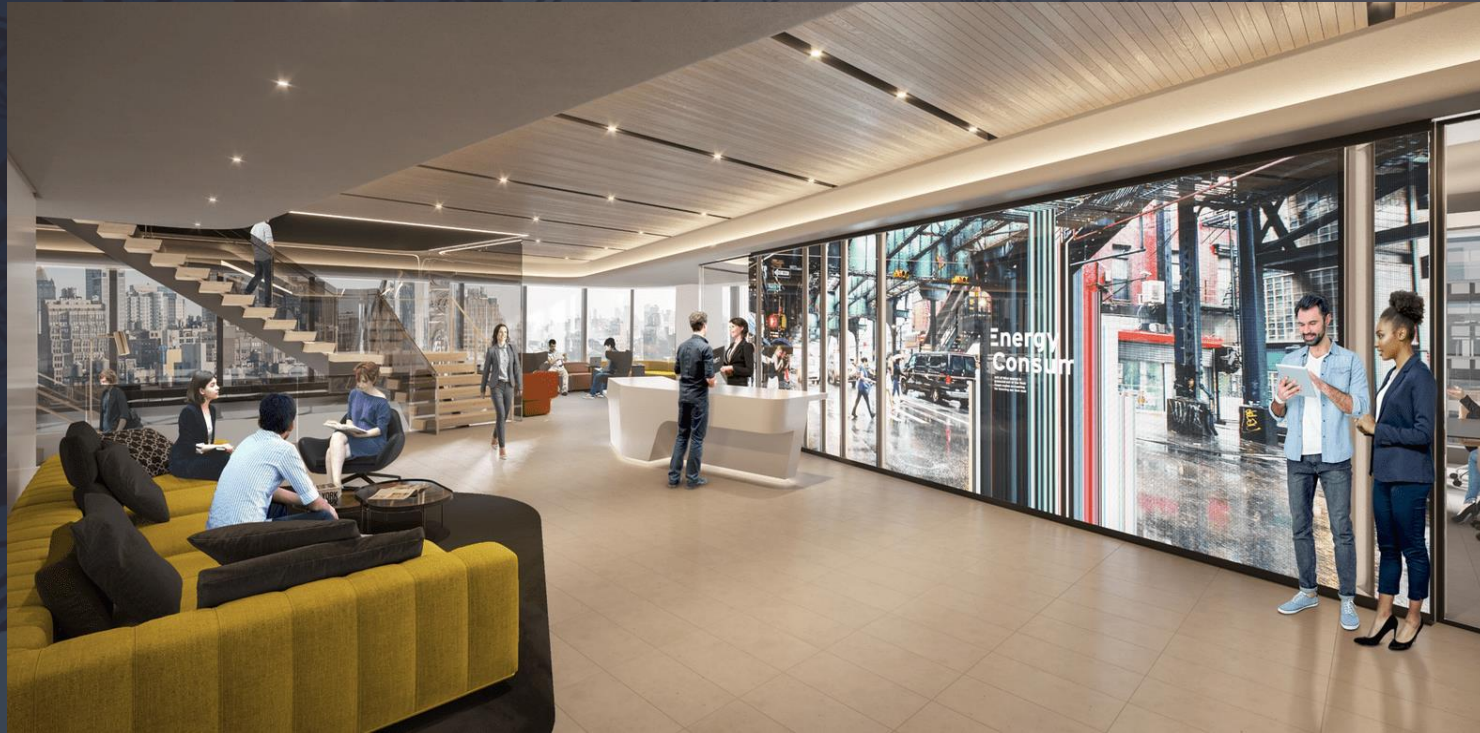
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Is your organization considering any of the following activities as it reimagines its footprint and experience in response to new ways of working after the pandemic?

Choose all that apply.

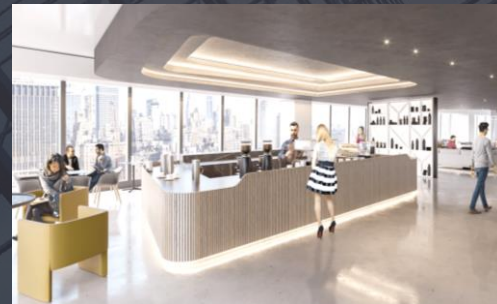
A	Investing in employee experience (benefits, stipends, programs)	41.50%
B	Investing in workplace experience (amenities, services, connection spaces)	34.70%
C	Building a coalition across HR, real estate, tech to better define and deliver on new ways of working	16.00%
D	Piloting or implementing hybrid work in advance of broader investment strategies	37.40%
E	None of the above	26.00%

# One Manhattan West



## Ernst & Young LLP headquarters (New York City):

- ▶ July 2021 grand opening
- ▶ LEED certified, WELL Health-Safety rating, Fitwel two-star rating (anticipated)
- ▶ Natural lighting, ergonomic furniture, collaboration spaces with advanced technology
- ▶ 6 flights of open feature stairs
- ▶ Diverse choices for individual and collaborative work
- ▶ 3 cafés with barista service
- ▶ Micro markets and grab-and-go options
- ▶ Live plants throughout workspaces
- ▶ Smart building sensors
- ▶ Manhattan West and Hudson Yards hub of creativity, innovation and wellness with art, retail, dining, entertainment and activated outdoor spaces



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