CLEARCAPITAL, LLC
THE UPSIDE OF REAL ESTATE

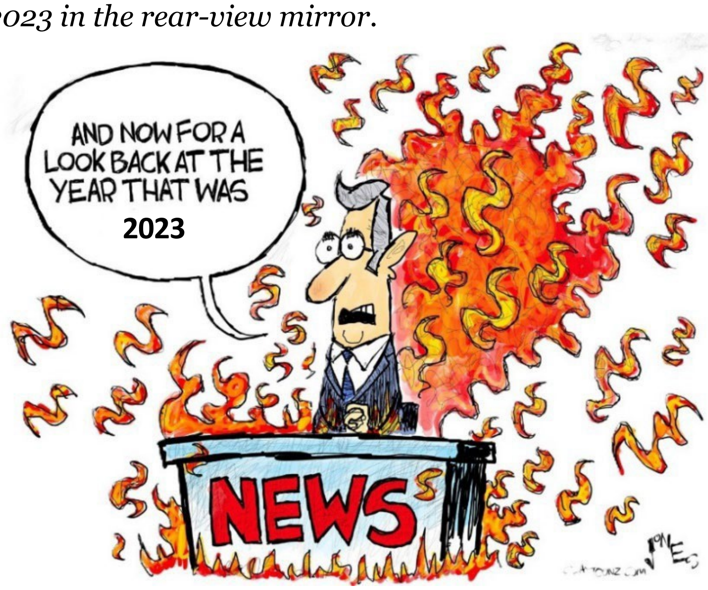
“Adversity does not build character, it reveals it."
— **James Lane Allen**

“I never said half the things I said.”
—**Yogi Berra**

While normal folks were or should have been out shopping, watching college Bowl Games or performing feats of strength during Festivus celebrations (for those unfamiliar, Google…or Bing, if you must) during the recent holiday season, I was immersing myself in yet another Twilight Zone Marathon on SyFy, one of my more suspect holiday rituals, other than consuming excessive quantities of English toffee and whatever chocolate is within reach.

Even after watching every episode (and some multiple times), I never cease to be amazed at Rod Serling’s prescience and brilliant commentary about human nature, good versus evil, moral and philosophical conflict, and mass hysteria, among other fascinating themes. Maybe I simply have this unquenched urge to send a few folks - mainly politicians and a few media personalities - to the proverbial cornfield, or long to own a camera that takes pictures of the future or a magical stopwatch that freezes motion. Or perhaps I am simply longing for anything that could help me make better sense of the economy and financial markets, as I try to predict what 2024 might have in stake and was hoping that Twilight Zone camera might be available on eBay…or anywhere.

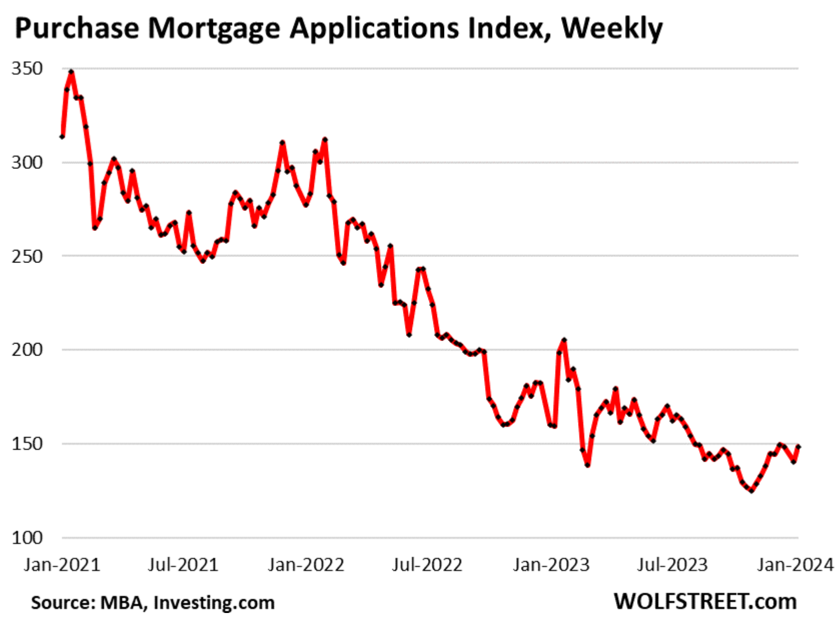
Well, before I jump into thoughts about 2024, unaided by any magical camera, what I can say is that I am glad to see 2023 in the rear-view mirror.



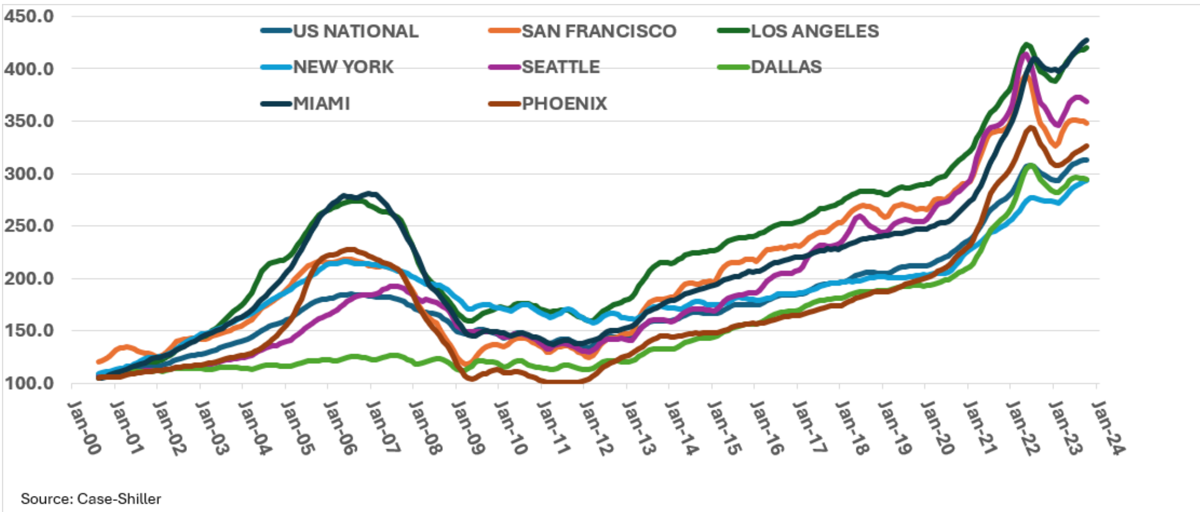
While equity markets and home prices were somehow able to withstand sharp increases in interest rates last year, I can't say the same about commercial real estate values, especially office buildings. However, even multifamily and industrial assets, market leaders for years, have struggled in the face of these higher rates, challenging capital markets and reduced liquidity, damaged investor confidence, and increased supply, all providing meaningful headwinds. Otherwise, 2023 will mostly be remembered for a Chinese spy balloon, the ongoing Russia-Ukraine conflict, Middle East unrest, non-stop political theatre, college campus shenanigans, and devastating natural disasters (e.g., Maui). And this was before the Jeffrey Epstein travel logs were released (for the record, neither Jimmy Kimmel nor I are mentioned).

However, a few significant themes emerged, some of which will certainly persist into and materially impact 2024:

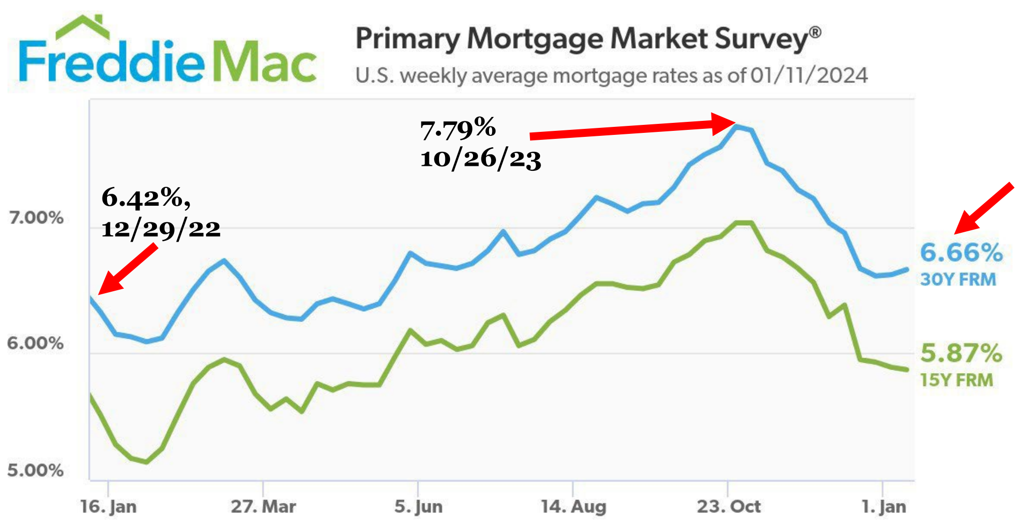
- **Housing slowdown**: 2023 witnessed a significant decline in single-family real estate transactions (sales and financing), a trend which will persist through at least the first half of 2024 and perhaps beyond. In 2023, there were some 4.1 million single-family home sales (existing and new construction), the lowest transaction volume since 1995 (that's ≈28 years, for anyone counting). As the single largest component of U.S. economic output (roughly a third), the slowdown will present a meaningful drag on GDP and could tip us into recession later this year.



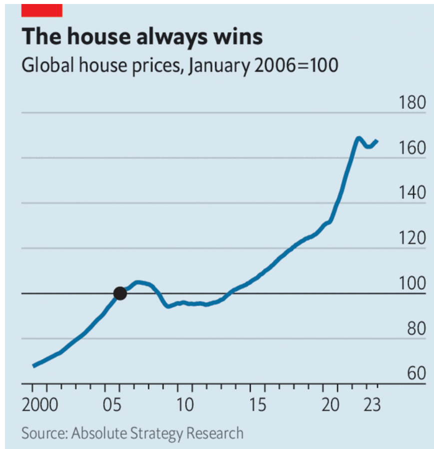
However, while transaction volume declined sharply, housing prices were firm, up marginally overall during the year, though some markets outperformed others, of course. Across the twenty largest markets (Metropolitan Statistical Areas), all were higher during the year, at least through the third quarter, including San Francisco (up 6.7%), Phoenix (up 6.1%), New York (up 7.6%), and Miami (up 7.1%). In fact, single-family home prices were higher in virtually every market, in every month, quite a performance given the higher mortgage rates that persisted for most of the year. And with mortgage rates dropping since they peaked in late-October, housing prices should remain firm in 2024. The latest Case-Schiller housing data, through the third quarter is as follows:



Meanwhile, mortgage rates ended the year well off their October high of nearly 7.8%. At last glance, Freddie Mac's 30-year mortgage rate was 6.66%, not far from where it started the year (6.42%), but merely looking at these two distinct time frames ignores the Space Mountain rollercoaster-like movement in rates that characterized the year.

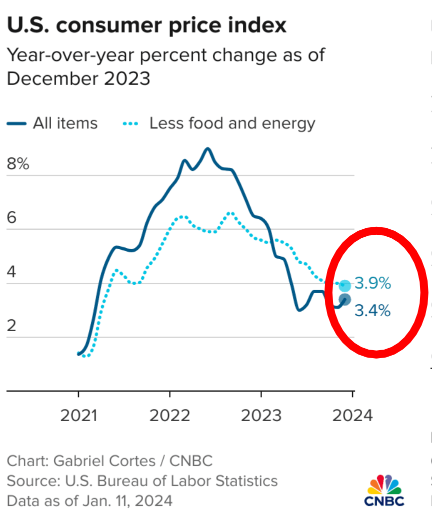


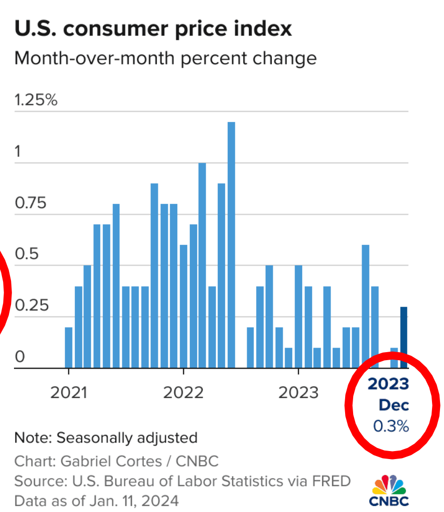
Oh, and by the way, higher single-family housing prices are not just a U.S. phenomenon. Housing prices have risen sharply across the globe over the last dozen years, and while prices paused a bit last year, they rose modestly in 2023, again, despite a higher rate environment.



- **Inflation pulls back**: After hitting a peak in June 2022, when inflation exceeded 9%, food and energy prices have declined, wage growth cooled, and the cost of goods globally have dropped. In December, the U.S. consumer price index increased 3.4%, year-over-year, and 0.3% month-over-month. While these inflation prints exceed the Fed's 2.0% annual target, inflation is clearly moving in the right direction. Keep in mind that the December 2022 CPI was 6.5%, year-over-year.

  As the economy cools, layoffs in tech, finance, banking, and real estate accelerate, shelter costs moderate, and consumers likely cut back on their breakneck spending (see below), I expect future inflation to soften further. But with expanding global unrest (read: expansion of Middle East conflict to Yemen, Lebanon), exogenous events may upend the inflation apple cart. We shall see.





Of course, headline inflation data masks underlying, more granular data, and in December, all of the principal components of inflation – housing, transportation, food and beverages – were higher. However, "shelter costs," the largest component of consumer prices, have declined for three straight months and I anticipate further declines over the first half of 2024.

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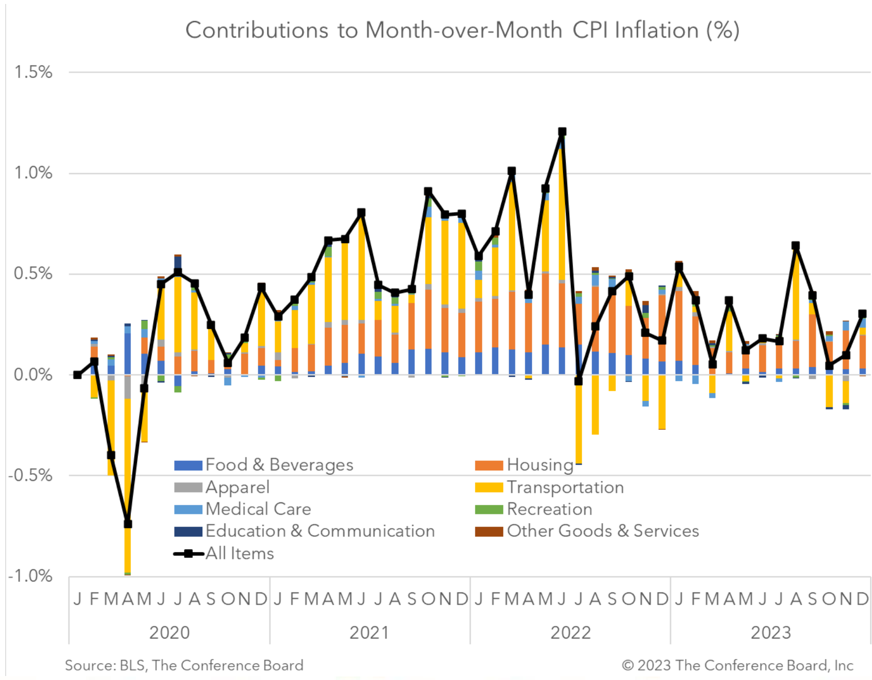
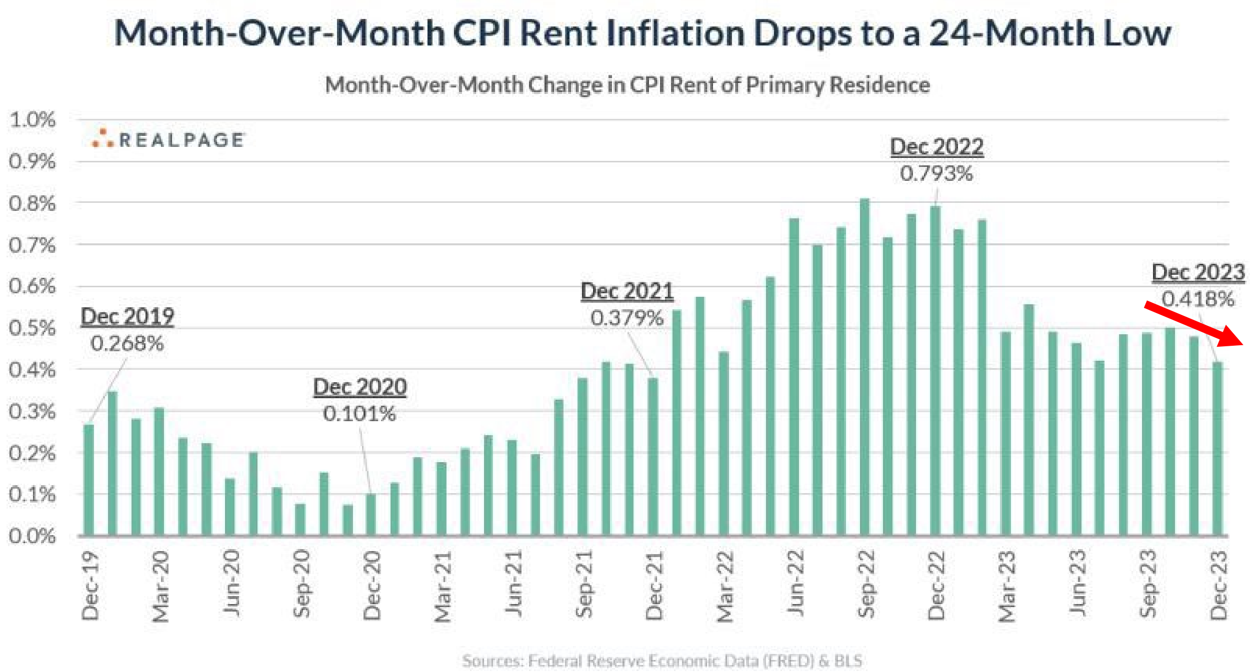
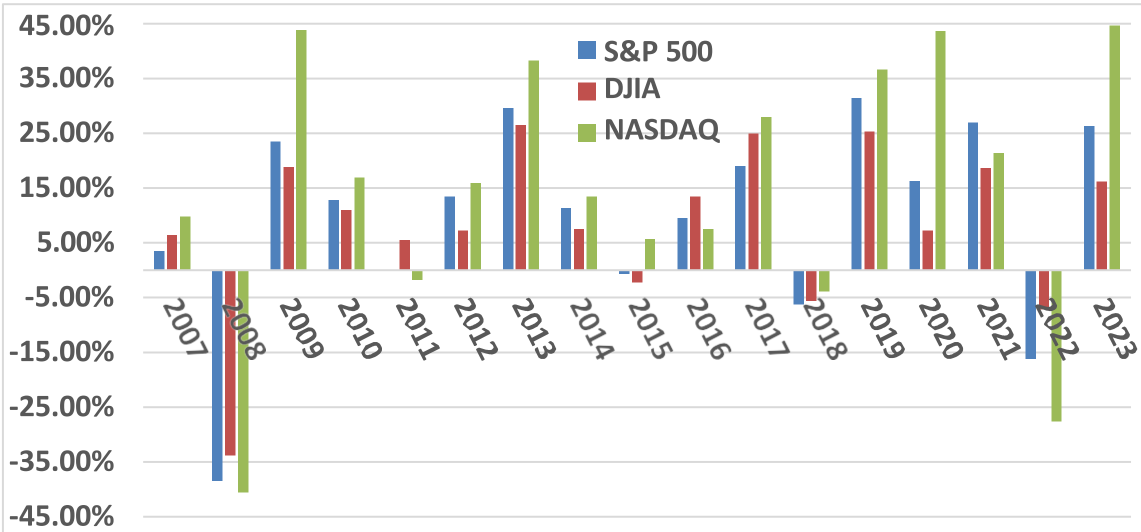




Globally, inflation rates are all over the proverbial map. While high inflation continues to wreak havoc in Turkey (annual inflation exceeds 60%) and Argentina (annual inflation was 211.4% in December…and that is not a typo), the U.S. has one of the lowest inflation rates in the world. Meanwhile, prices declined in China for the 15th consecutive month.

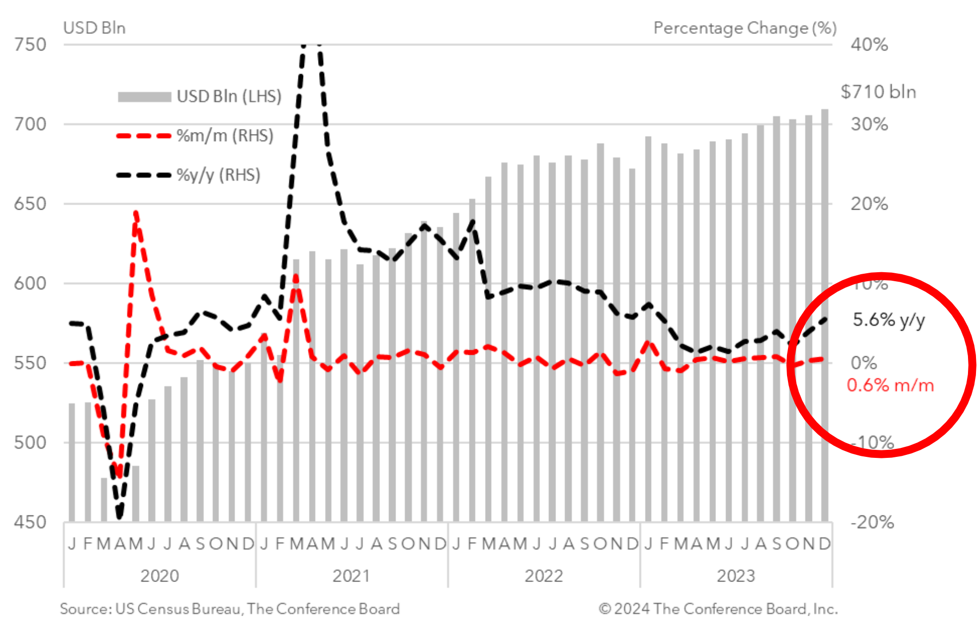
- **Robust equity markets**: in 2023, to my surprise, U.S. equity markets recaptured all of 2022's losses and then some, higher rates be damned. Optimism about AI – perhaps excessive – and surprisingly decent earnings growth drove the markets higher. If anyone had told me in late 2022 that the S&P 500 and NASDAQ would be up 26.3% and 43.3%, respectively, in 2023, I likely would have asked about their favorite tequila or suspected that they had entered that fifth Twilight Zone dimension. I would be shocked if 2024 presents a 2023 encore, but markets have an uncanny way of revealing the unexpected, and as mentioned below, there is still plenty of dry powder on the sidelines, with some $8 trillion sitting in money market funds and certificates of deposit (see below).



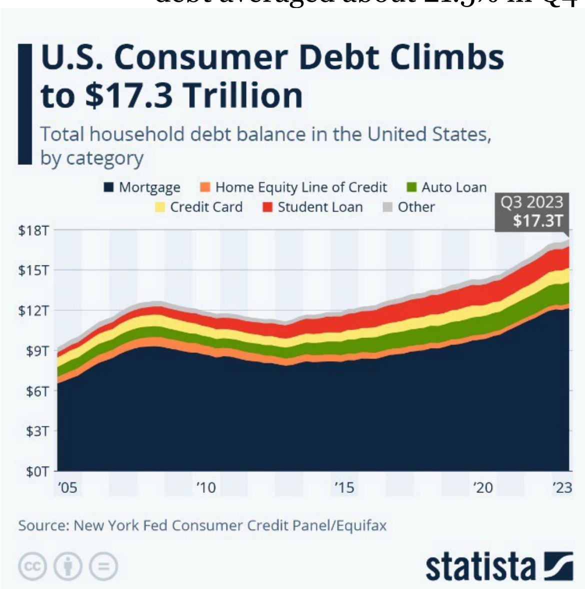
Source: Bloomberg

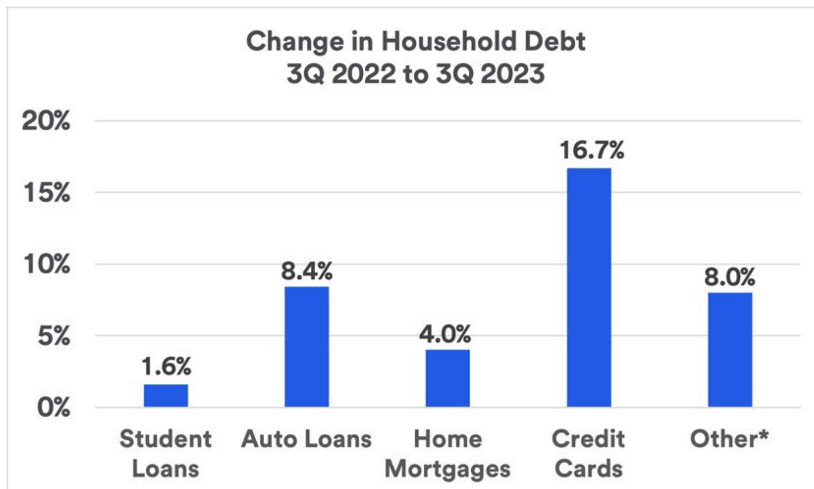
- **Consumers continue to spend and spend….and borrow:** Retail sales were surprisingly strong in December, up 0.6% month-over-month, and 5.6% year-over-year, above expectations. Keep in mind that these figures represent improvements over November (up 0.4% month-over-month) and October, when retail sales declined 0.3%.

December Retail & Food Services Sales (Nominal)



How are consumers funding their seemingly insatiable urge to spend? Well, it looks like good old “OPM” (Other People’s Money), as consumers have been on a borrowing binge, at least through the third quarter. Consumer debt now exceeds $17 trillion, a record, and year-over-year, all forms of consumer debt increased, especially credit cards, up nearly 17% in Q3 2023 versus the prior year. And keep in mind that the APR (annual percentage rate) on this credit debt averaged about 21.5% in Q4 2023. Yikes!

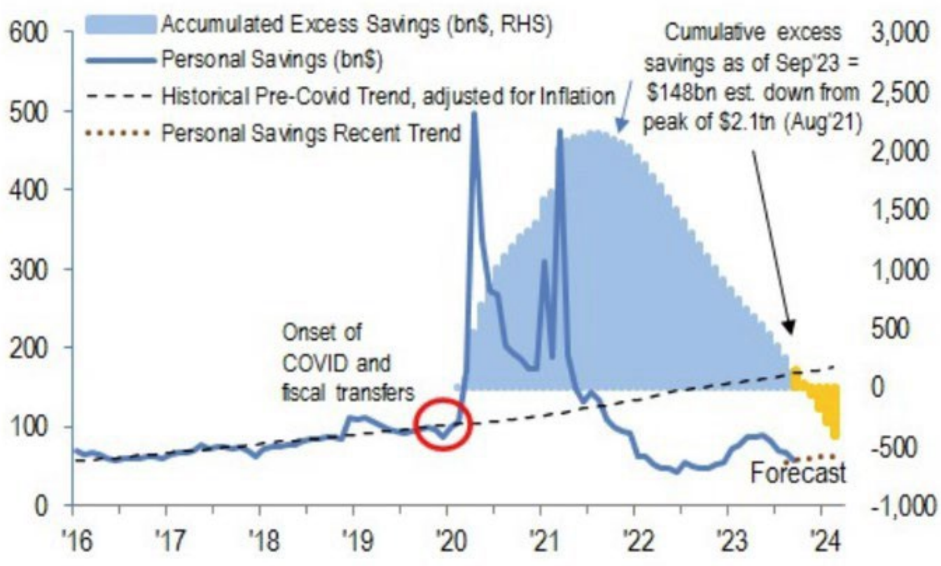




So, how much mojo does the U.S. consumer still have in the tank? December’s retail sales results would seem to indicate the consumer is still alive and kicking. But then, I see several headlines which give me pause. Exhibit A would be a reasonably recent announcement from Walmart, which disclosed “concerns over consumer health” in mid-November and then, in early December, the company disclosed that “consumer behavior would be difficult to predict next year.” Investors did not react positively to the disclosure.

And then there are other conflicting data points. On the one hand, I have seen numerous graphs and charts indicating that the "excess savings" accumulated during Covid, and subsequent government largesse have been spent, and common sense would indicate this is likely true, at least for most.

Figure 24: Household "Excess Savings" Almost Gone

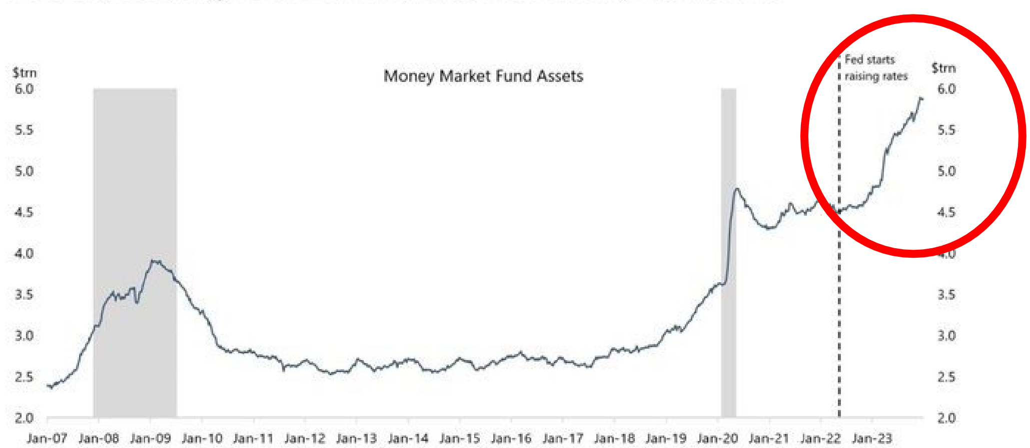


Source: J.P. Morgan Equity Macro Research, Bloomberg Finance L.P.

However, then I see this telling graph, indicating that a record $6 trillion is presently sitting in money market funds ($8 trillion, if you include certificates of deposit), attracted to the compelling 4.5%+ yields they are now earning. What happens to these funds if and when interest rates decline, uncertainty around the upcoming election subsides, and consumers begin to feel more bullish? Are these money market assets destined for the equity markets? Commercial real estate? It's hard to say, but consumers and investors are a fickle bunch, so psychology and risk tolerance move fast, just like life, as Ferris Bueller keenly observed.

APOLLO

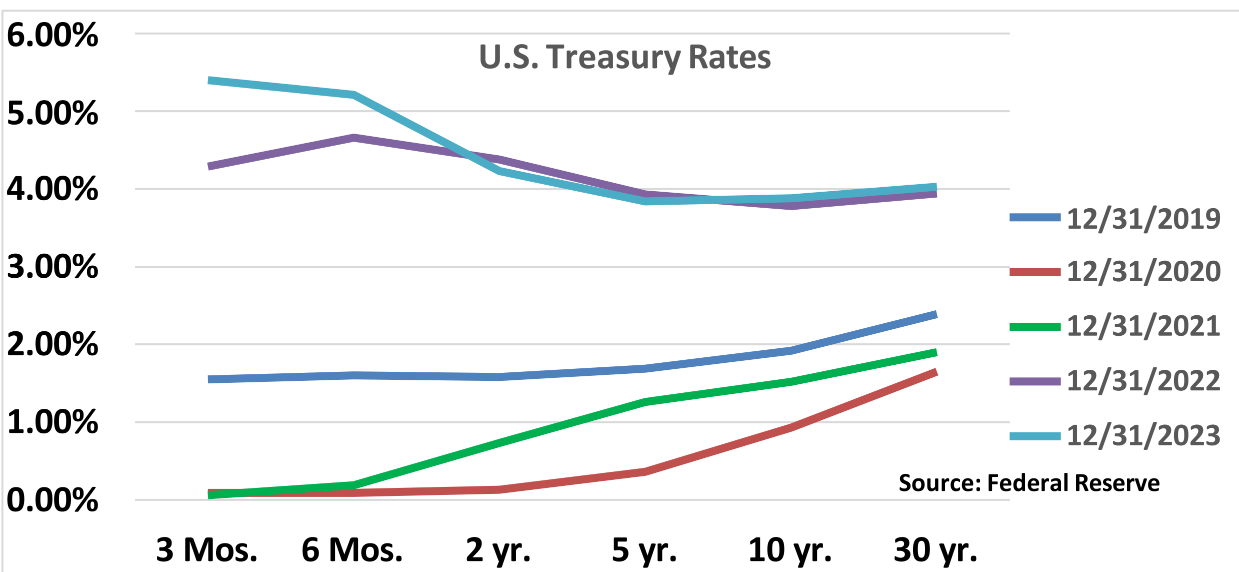
There is a record-high $6 trillion on the sidelines in money market funds



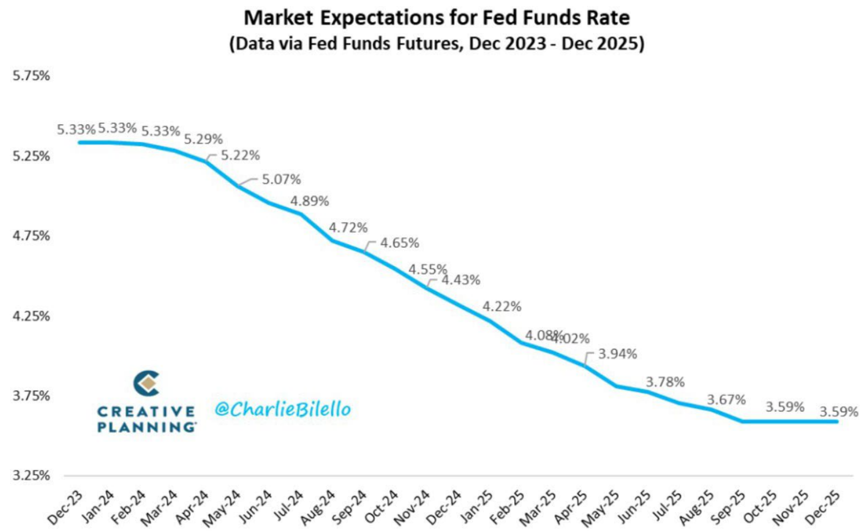
Meantime, consumers have become more confident about the economy and inflation towards the end of 2023 and headed into 2024. According to the University of Michigan's monthly survey (congratulations to Big Blue fans and alums, by the way), consumer confidence is at its highest levels since July of 2021, and up over 21% from a year ago. So, consumers may or may not be out of spending fuel, but they are still feeling surprisingly good, nevertheless. Maybe that is why they are so eager and willing to borrow to spend.

What is strange is how to reconcile this increase in consumer confidence with the results of a recent CNN poll, in which 71% of Americans said that "economic conditions in the country were poor," and over a third (38%) labeled them "very poor." Perhaps the silver lining is that 82% said the economy was poor last year, so I suppose we can jump for joy knowing Americans think conditions are "less poor." It becomes increasingly challenging to reconcile the conflicting data points. Perhaps it is just media and politics in a very divisive environment in an important election year. Perhaps it is the nature of a response to a particular inquirer (e.g., CNN versus the University of Michigan) or a particular manner in which data is gathered. Perhaps consumers themselves are having trouble squaring all the conflicting data. I will provide my own views at the conclusion of this monstrosity.

- **All eyes are on the Fed**: Jerome Powell must feel like a runway model or contestant on America's Got Talent the way that folks hang onto every word he utters and every move he makes, looking for clues as to what the Fed might do next. After raising rates relentlessly for 18 months, the Fed paused rate hikes in the middle of 2023 and has not raised rates since, telegraphing that instead, it intends to reduce rates three times in 2024. In fact, what the Fed will do in 2024 is the biggest mystery since Jimmy Hoffa went missing.

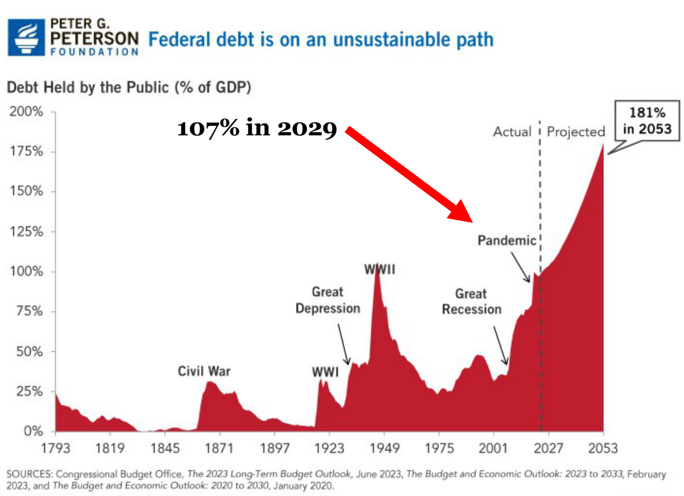


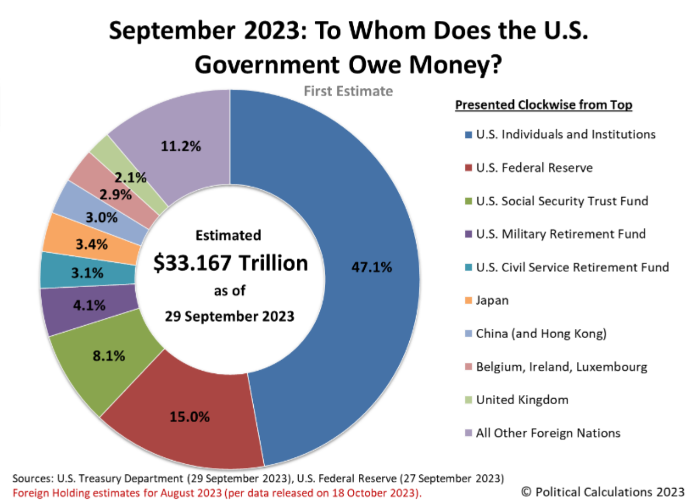
Subsequent to Powell's initial comments in mid-December, the equity markets rallied strongly, surging to new records, and the 10-year Treasury yield dropped below 3.90%. However, more recent economic data, including those stronger-than-expected retail sales and a surprisingly strong job market (see below), may upend the plans of mice, men (or should I say "people"?), and Mr. Powell. What's curious is that the markets are expecting six or seven rate cuts this year, based on the Fed Funds forward curve.



However, representatives of the Fed with last names other than Powell (e.g., New York Fed President, John Williams; Dallas Fed President, Lorie Logan; and, Fed Governor, Michelle Bowman) have been more circumspect about the prospects of future rate cuts, indicating they would not hesitate to raise them should inflation take a turn and head higher. Every time someone from the Fed speaks, it is like one of those old EF Hutton commercials, with everyone dropping all else they may have been doing to listen closely for any clues to help them better read the tea leaves. Severe cases of bond and investor whiplash often follow given the inconsistent and sometimes contradictory messaging from various voices at the Fed.

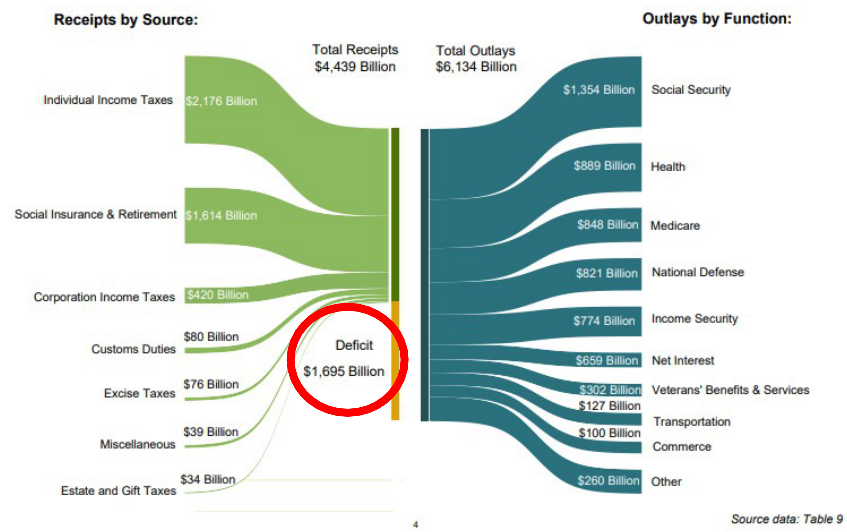
- **Expanding Federal deficits here, there, and everywhere**: In a newsflash surprising no one, it appears that governments everywhere have a consistent inability to balance their budgets, routinely spending more than they collect in tax and other revenue. According to the IMF, the U.K., France, Italy, and Japan are running deficits of about 5% of their respective GDPs. In the U.S. 2023 saw a staggering $2 trillion deficit, representing about 7.5% of GDP and about twice what was anticipated a year ago. With outstanding U.S. debt exceeding $34 trillion, the Fed's Balance Sheet is in some serious need of Ozempic, and with Congress in a state of seeming paralysis, it is unclear when, if ever, we will get our fiscal house in order.





While our total debt is still manageable at 122.9% of nominal GDP, it is staggering to think that the ratio was roughly 33% in 1980. Meanwhile, with those nearly $2 trillion annual deficits (see below), the debt situation will not improve anytime soon. Who will be buying all our debt remains to be seen, if China, Japan, and Saudi Arabia develop a chronic case of treasurydebtitis, a unique case of financial indigestion? Perhaps it will have to be the Fed itself, in a sequel to Quantitative Easing 3. Look for the upcoming release of “QE4: The Reckoning” on a streaming outlet near you, to be released later this year.

Figure 2. Cumulative Receipts, Outlays, and Surplus/Deficit through Fiscal Year 2023



So, with that 2023 backdrop, what should we expect 2024 to look like? In order to help me gain better insight into what 2024 may hold in store, I assembled a cracker jack team of psychics, pundits, and wizards, including Carnac, Cleo, and Dumbledore (again, Google away, or Ask Jeeves, if he’s still around).

Frankly, after these professional psychics made some absurd predictions about the NY Jets winning next year’s Super Bowl and the Golden Bachelor’s marriage working out, I realized I might be better off seeing what the second string has to say, so I took note of the the following forecasts by the Federal Reserve, Moody’s, Fannie Mae, the Mortgage Bankers Association, and the National Association for Business Economics. Here are <u>their</u> predictions for GDP, CPI, and unemployment.

Economic Forecasts

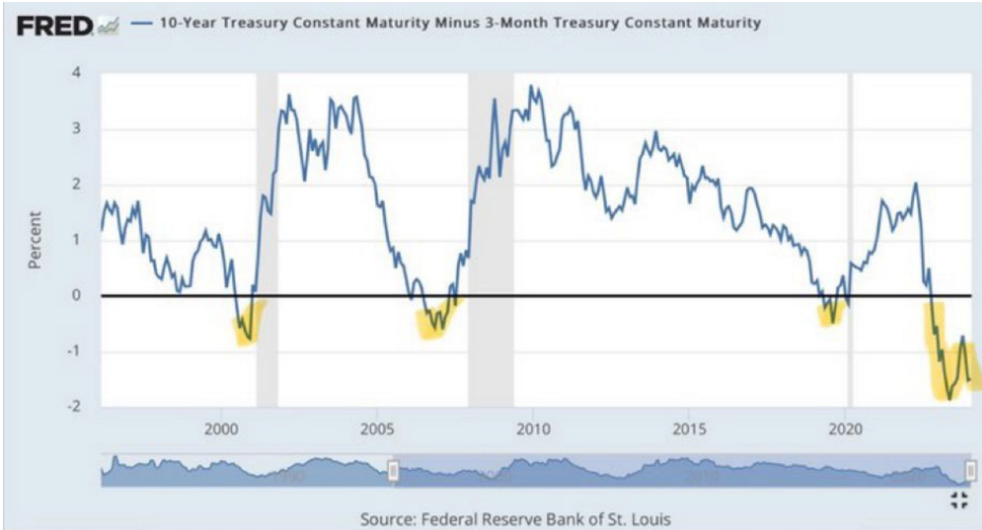
	2023			2024			2025		
	GDP	CPI	Unemplymt Rate	GDP	CPI	Unemplymt Rate	GDP	CPI	Unemplymt. Rate
Federal Reserve Board	2.1%	3.3%	3.8%	1.5%	2.5%	4.1%	1.8%	2.2%	4.1%
Moody's Analytics	2.4%	4.2%	3.7%	1.7%	2.8%	4.0%	1.7%	2.2%	4.1%
Fannie Mae	2.6%	3.1%	3.6%	-0.4%	2.1%	4.6%	1.6%	2.6%	5.3%
Mortgage Bankers Association (MBA)	2.5%	3.2%	3.7%	0.4%	2.4%	4.6%	1.7%	2.1%	4.7%
National Association for Business Economics (NABE)	2.1%	4.1%	3.6%	1.1%	2.6%	4.2%	N/A	N/A	N/A

Notes: The Federal Reserve Board forecasts Personal Consumption Expenditures rather than CPI.
Annual figures for GDP and CPI are expressed as annual average, except Moody's Analytics.

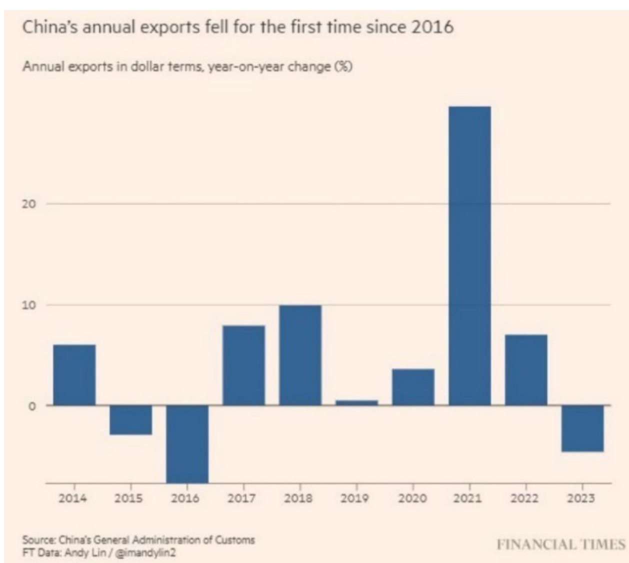
One cannot help noting the wide disparity of forecasts. Fannie Mae projects a recession in 2024, a decline in GDP by -0.4% this year, a far cry from the 1.7% in growth forecast by Moody's. And if this particular group of forecasters can't agree, consider a recent Wall Street Journal survey of 100 professional economic forecasters. They expect U.S. GDP to increase by a whopping 1% (no recession), essentially in the middle of the forecasts set forth above. The bottom line? Psychics are useless and "professional" forecasters do not seem to agree on much.

For my part, I think 2024 is going to be a challenging year. I foresee continued weakness in real estate - residential and commercial - especially as mortgages mature, rates on floating rate loans reset, interest rate caps expire, and capital calls become even more pervasive. Here are a few of the warning signals and headwinds I am watching closely in order to better gauge what is to come this year.

- **The inverted yield curve**: The yield curve (e.g., rates on U.S. Treasury securities at varying maturity dates) has been inverted for over a year, with long-term rates yielding less than shorter-term yields. For example, at last glance, the 3-month T-Bill rate was yielding 5.4%, while the 10-year rate stood at about 4.1%. Typically, inverted yield curves foretell economic slowdowns, if not recessions. In fact, since all eight of the past recessions in the U.S. were preceded by 10-year yields were less than those on 3-month securities. To be fair, there have been false negatives when this phenomenon occurs, but not since 2000.

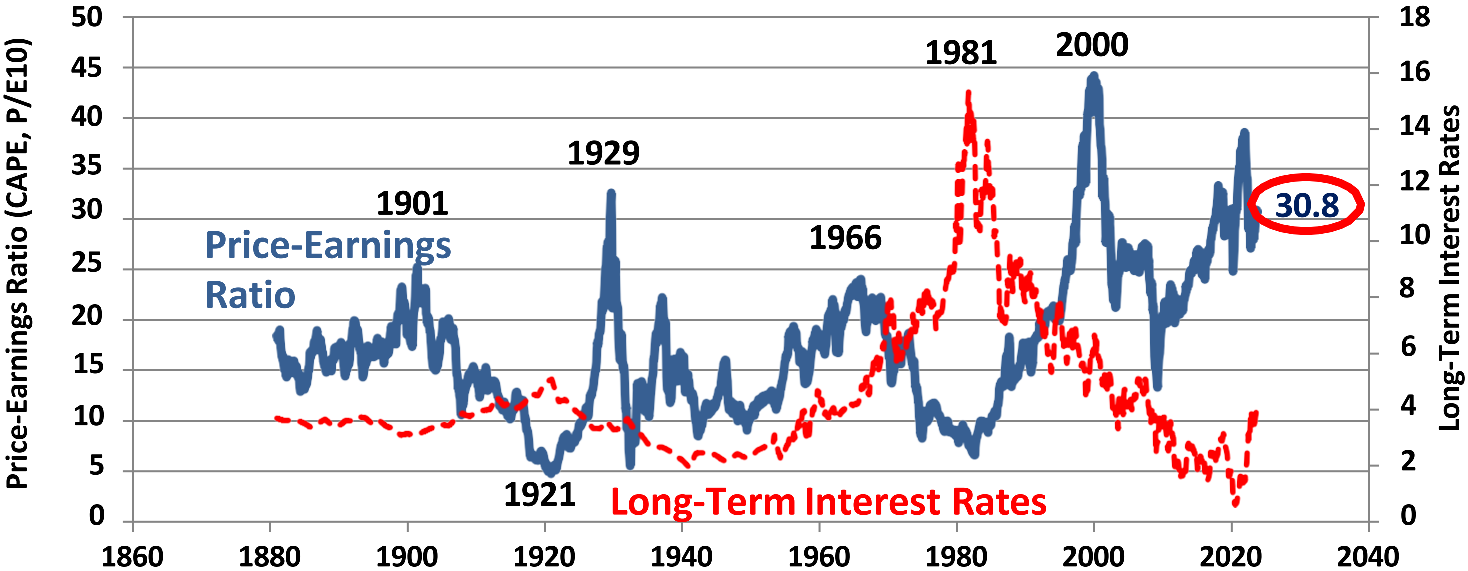


- **Global growth concerns**: According to the World Bank, the global economy is "headed for the worst half-decade in 30 years," which would translate to the weakest period of economic growth since the early 1990's. Let's face it. The Russia-Ukraine conflict and Middle East unrest, coupled with global inflation and higher interest rates, present serious economic headwinds. FedEx recently cut profit forecasts, while the cost of sending a container from China to Europe has climbed 114% over just the past month, as ships avoid the Red Sea, potential attacks by the Houthi, and instead, send ships around Africa, at an incremental cost of $1 million in fuel costs and an additional 10-day delay. China's annual exports fell last year for the first time since 2016. The U.S. is not immune from these global influences, of course.



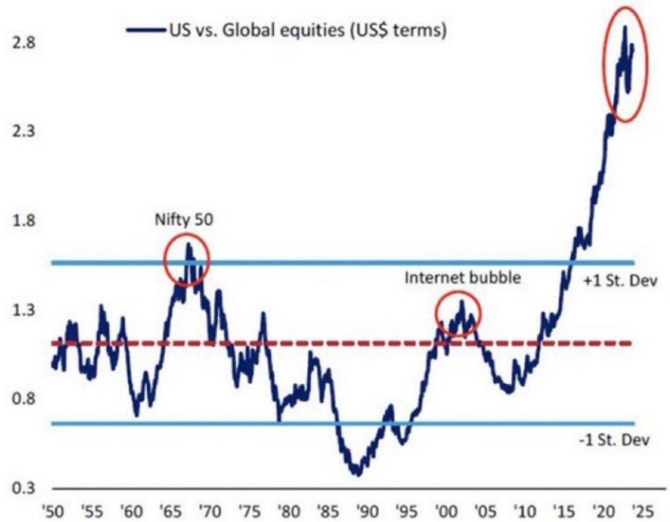
- **Equity markets are expensive and market breadth disappointing**: While the equity markets performed better than admirably last year, there are concerns lurking under the hood. The "Big Seven" in tech (e.g., Nvidia, Alphabet/Google, Meta, Apple, Amazon, Tesla, Microsoft) were up 75% in 2023 alone and now comprise 30% of the entire S&P 500's value.

Maybe it is merely the "rich getting richer" or in times of uncertainty, "stick with the known," but the lack of breadth is concerning, especially with the market trading at some thirty-one times earnings, levels that have not been seen in over 20 years. There is still plenty of froth out there, and I have not even mentioned the rally in Bitcoin or Coinbase, up over 150% and 250%, respectively, since the start of 2023. The true fundamentals behind such a rise escape me.



In addition, U.S. equity prices have never been so expensive as compared to international stocks. Again, perhaps it is merely investors flocking to perceived safety, but we know how fickle investors can be.

Exhibit 32: US is near extreme peaks vs. global equities, well exceeding the 60s/70s Nifty-50 and 2000s tech bubbles
US vs. World ex-US equities (relative price performance, USD)

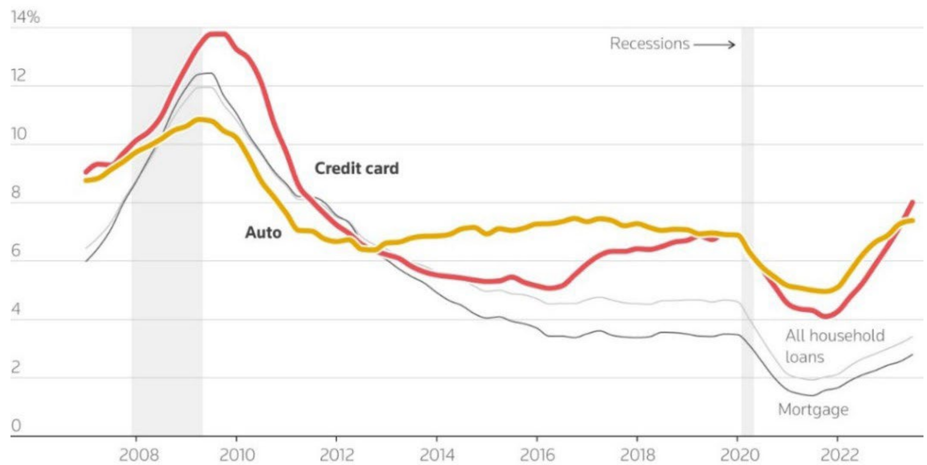


Source: BofA Global Investment Strategy, Global Financial Data

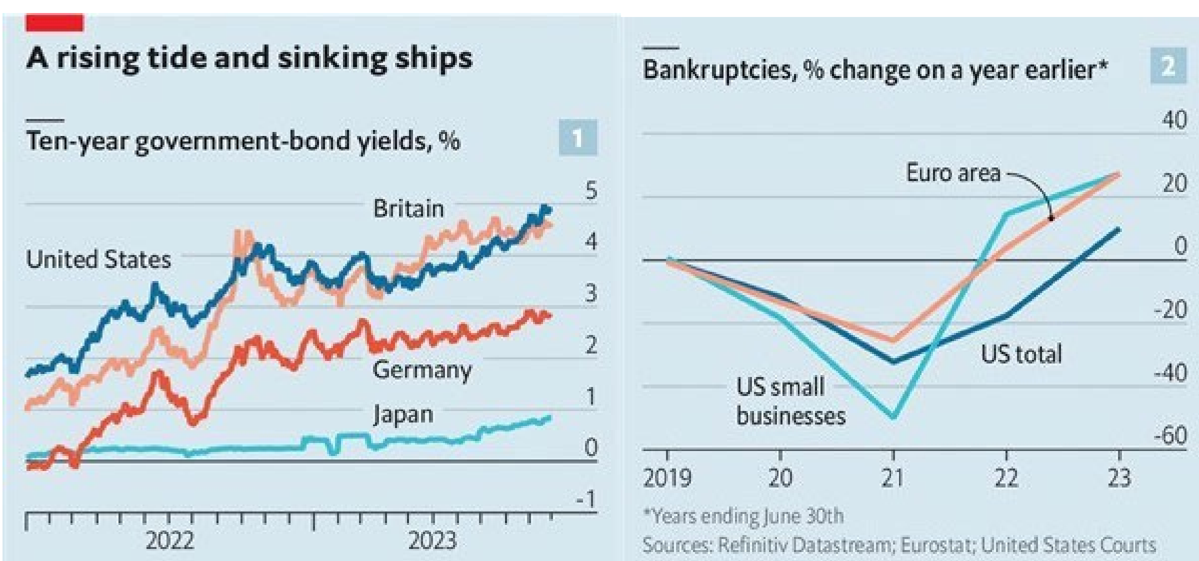
- **Increasing delinquencies and defaults**: It comes as no surprise that delinquencies and defaults on auto and credit card loans are starting to creep upwards, and I expect 2024 to witness even greater dislocation, as interest rates reset on floating-rate debt, and rate caps and/or debt mature. So much depends on what the Fed does, which in turn, of course, rests on how the economy performs and there is not much consensus there, as discussed. This trend is global, to be sure.

New delinquencies on the rise

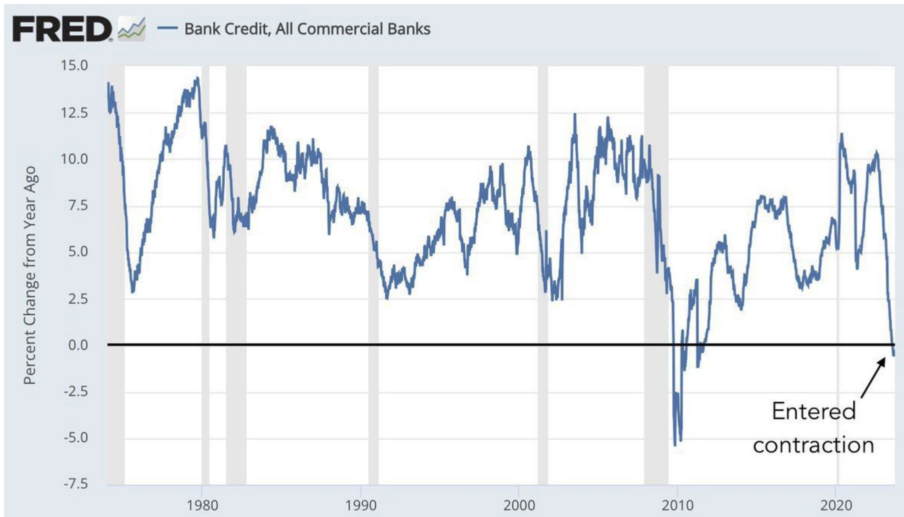
The share of U.S. consumer **auto** and **credit card debt** at least 30 days past due is up for seven quarters in a row. For car loans, the new delinquency rate is the highest since 2013. For credit cards, it is the highest since 2011.



Note: Latest figures are for the third quarter of 2023.
Source: Federal Reserve Bank of New York
Prinz Magtulis • Nov. 7, 2023 | REUTERS

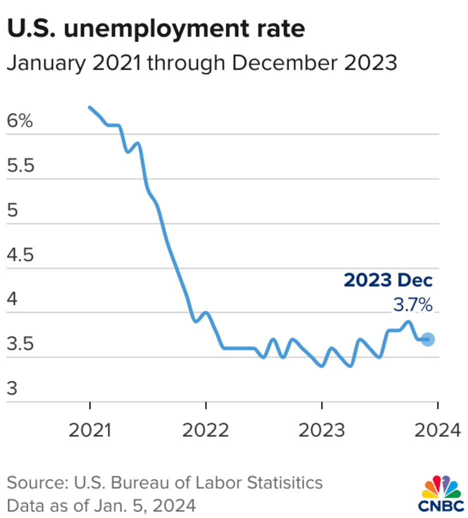


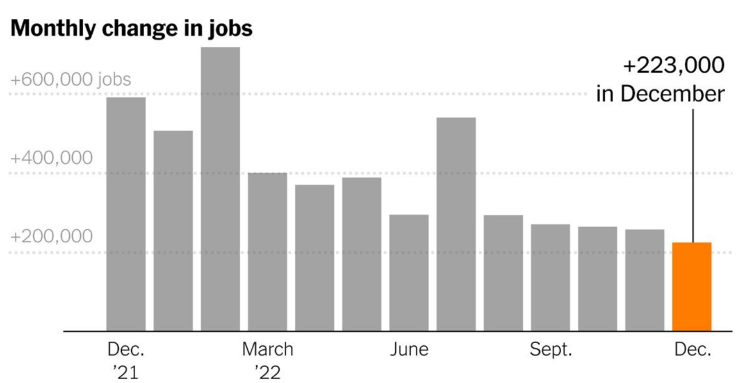
Not surprisingly, banks are pulling in their lending horns in response to the rising delinquencies and increased economic and market uncertainty. The 2024 economic drag resulting from this credit contraction presents a consequential economic headwind.



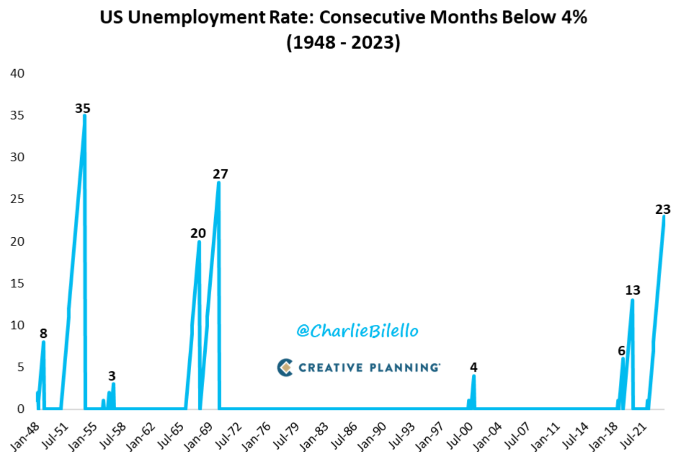
At least recent bank earnings announcements have allayed some concerns about the health of our banks. JPMorgan Chase just indicated that it made $50 billion last year, and collectively, JPMorgan, Bank of America, Wells Fargo, and Citibank earned $104 billion last year, up 11% from 2022. Obviously, we will have to see how regional and smaller banks are holding up amidst shrinking net interest margins and increased defaults and delinquencies.

- **Continued weakness in finance, tech, real estate, consulting hiring and increasing layoffs**: Overall employment figures remain robust, at least according to headline job data. The national unemployment rate sits at 3.4% after the economy added 223,000 jobs in December, above expectations. Increased hiring does not usually portend an economic slowdown. However, all of the economic forecasters, and even my three hired psychics, predict that unemployment will rise above 4% in 2024, with Wells Fargo proving the most bearish unemployment forecast of 4.5%.



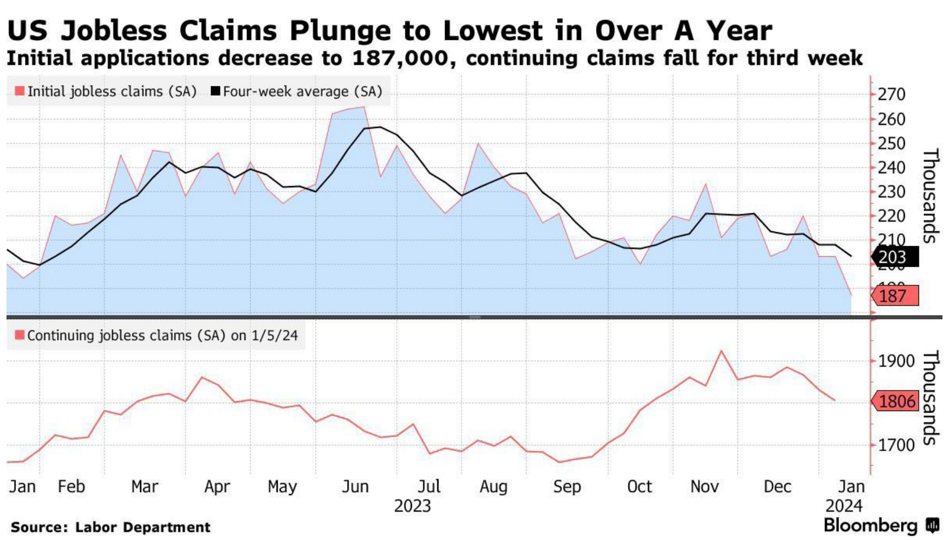


At this point, the unemployment rate has been less than 4% for twenty-three consecutive months. While some of this robust labor data reflects the recovery post-Covid, the last time the labor markets experienced this sort of uninterrupted level of unemployment was over 50 years ago, so it is still noteworthy. But is this sustainable? Is the labor market as healthy as it seems?

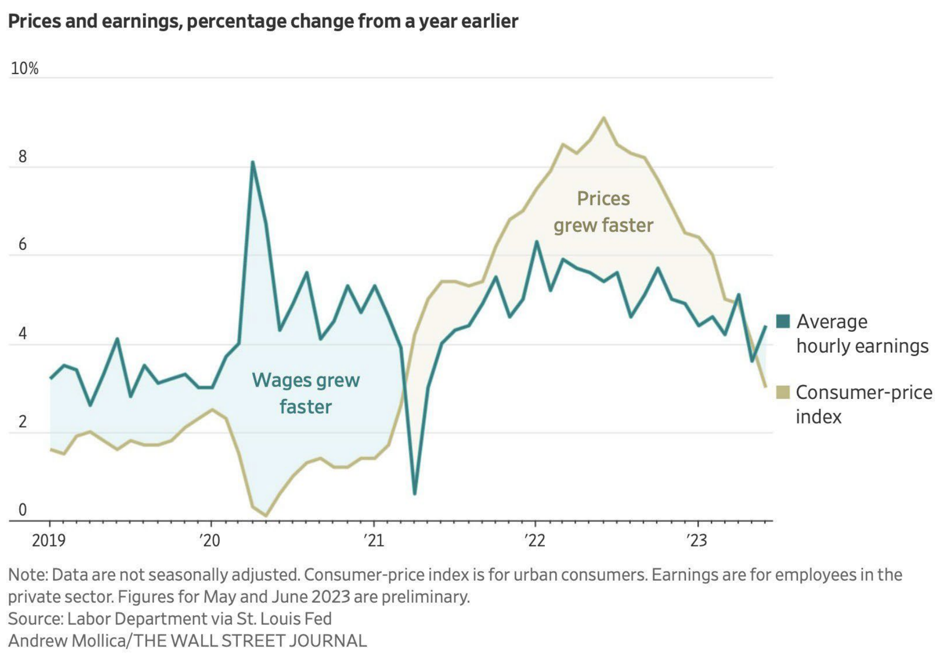


I find myself on the more bearish side, as I see more layoffs coming, especially among white collar workers. Consistent with this premise, we are barely three weeks into 2024 and the following firms have already announced fairly sizable job cuts: Amazon, Blackrock, Google/Alphabet, Intel, Nike, Citibank, Unity Software, IBM, Xerox, and Wayfair, among others. It may be that while white collar hiring lags, numerous job openings lurk in hospitality, bars and restaurants, childcare, and healthcare. College, MBA, and law school graduates are finding the employment market especially difficult, so perhaps it is once again, a tale of contradictory data.

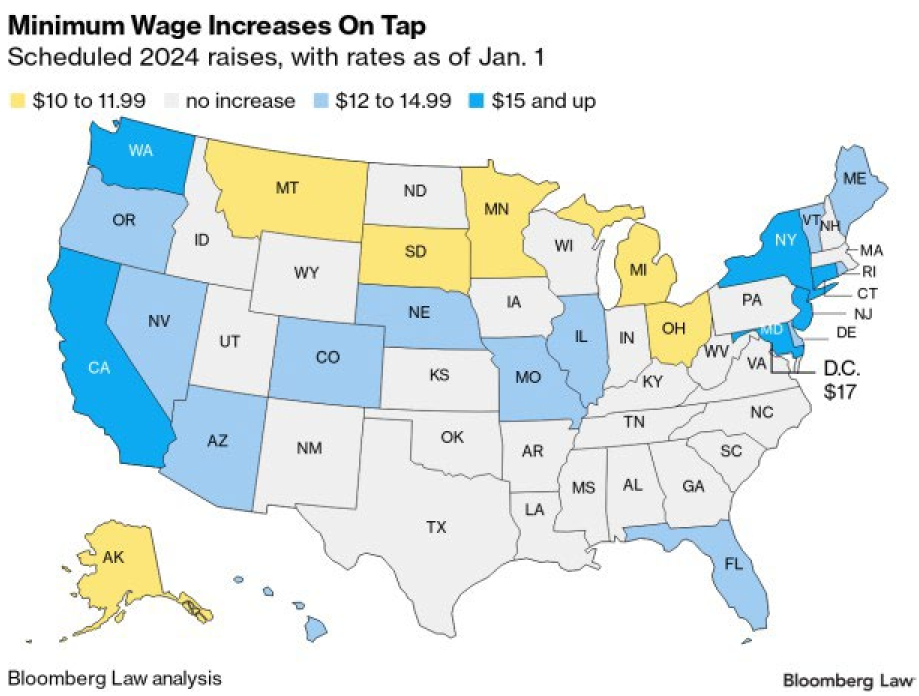
Consistent with this perspective, data out just last week indicates that jobless claims dropped sharply in December, to their lowest levels in over a year (187,000), so there you go. Signs of weaknesses in the employment market show up here and signals of strength in the labor markets show up there.



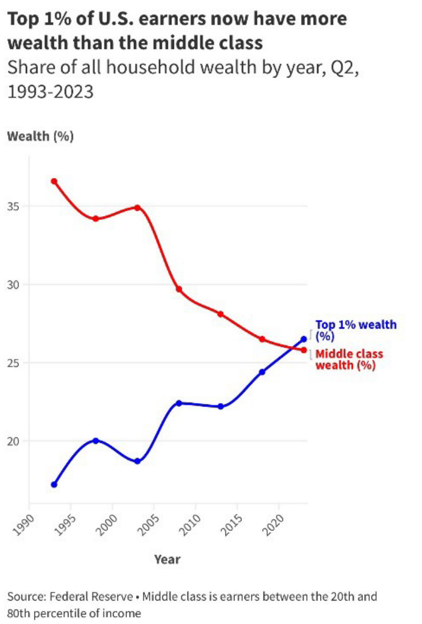
And what about wages? In 2023, wages increased 4.1%, essentially matching inflation, so the real (above inflation) wage gains that we witnessed in 2019 through the early part of 2021, have not persisted.

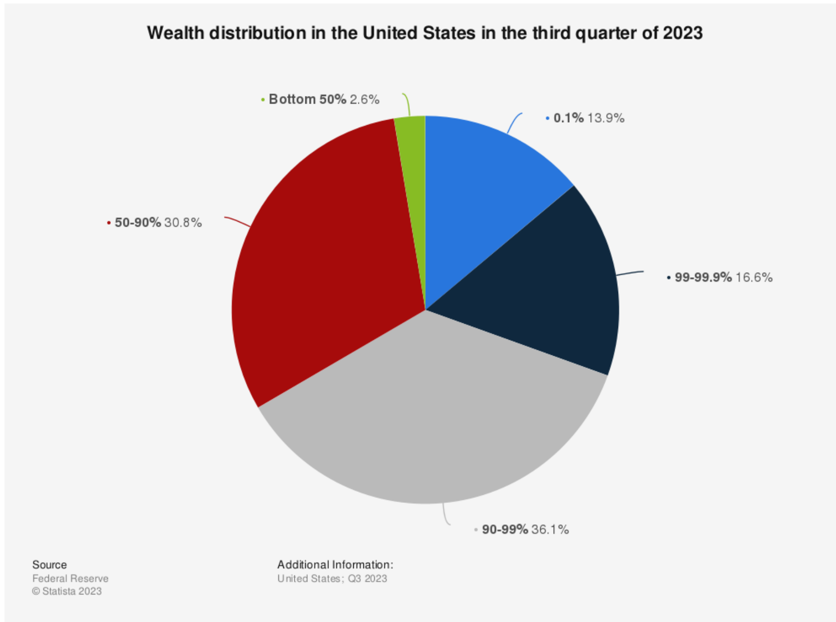


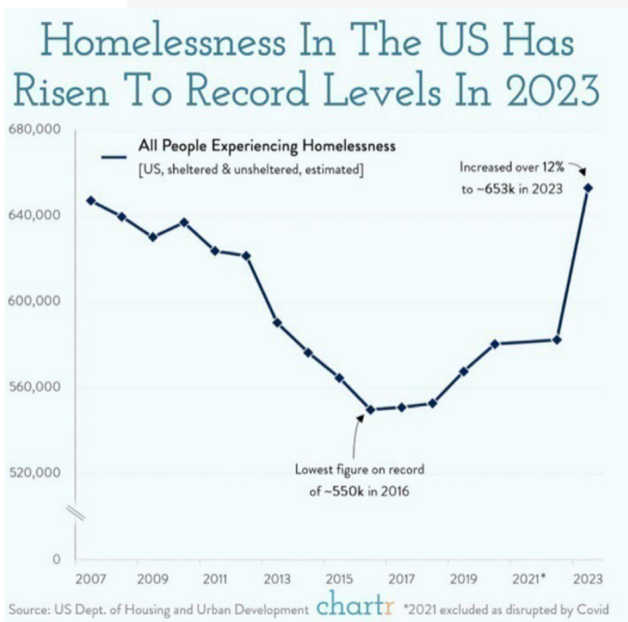
Meanwhile, almost ten million workers in twenty-two states received increased wages at the start of 2024, due to statutory hikes to the minimum wage in twenty-two states.



It really is a good news, bad news story. On the one hand, I think it is critical that the blue-collar workers and the middle class receive higher wages and achieve greater financial independence, along with increased savings and wealth. Our tenant base, being mostly blue collar, would benefit from higher wages, as would we. However, these pictures say it all. Wealth inequality in the U.S. continues to expand as the rich continue their wealth-getting ways and some rebalancing is crucial to our economic and political stability.





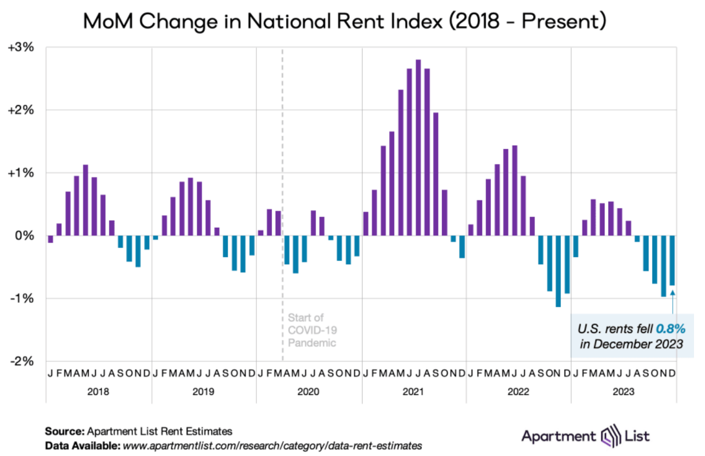


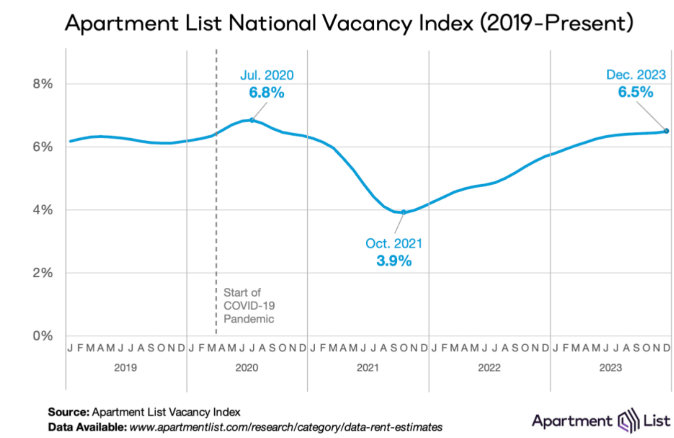
On the other hand (there always is that "other hand"), higher wages translate to higher consumer spending and higher inflation, all else equal, and we would like to see moderation of both to provide the Fed with increased incentives to cut interest rates. Hopefully, we can have our cake and eat it too, increasing wages and wealth of the middle class, while not placing unwanted pressure on prices and inflation.

CLEARCAPITAL, LLC
THE UPSIDE OF REAL ESTATE

Let's take a closer look at housing markets, both single- and multifamily

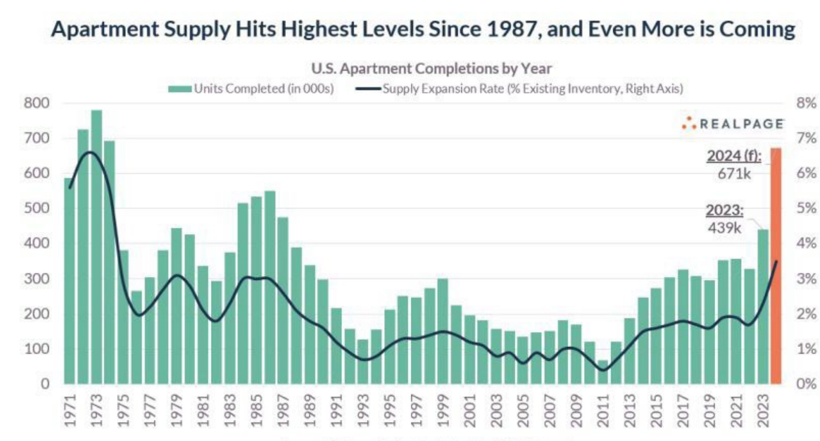
2023 was an odd year in the housing markets. As discussed, (arguably, ad nauseum), single-family home prices rose despite higher interest rates, while transaction volume dropped sharply, leading to odd headlines like "Home Prices Hit Record as Sales Fall." The result was an ever-expanding gap between the "cost to own" and the "cost to rent." However, multifamily fundamentals did not improve with these obvious tailwinds, as rents softened, albeit modestly, and vacancies ticked up. Rents nationally decreased 0.8% in December and vacancies ticked up, to 6.5% at year end.





Rents fell in 2023 across 40% of U.S. metros – and nearly all of them (primarily in the Sun Belt, Mountains, and West Coast) witnessed significant new supply added to the market. In stark comparison, nearly one-third of U.S. metros (almost all in the Midwest or Northeast), witnessed rent growth of 3% or more last year, generally in markets with limited new supply.

Indeed, supply remains the culprit and we will see increased supply this year before new supply falls sharply in 2025. Specifically, apartment supply jumped to a 36-year high in 2023, resulting from construction projects that started back when occupancy rates and rent growth were higher. Approximately 440,000 units were completed last year, and even more (671,000) are scheduled to be delivered this year. After that, completions will plunge due to the recent slowdown in starts linked to higher financing costs and softer fundamentals. In turn, occupancy and rents should rebound sometime in the latter part of the year, or perhaps in 2025.



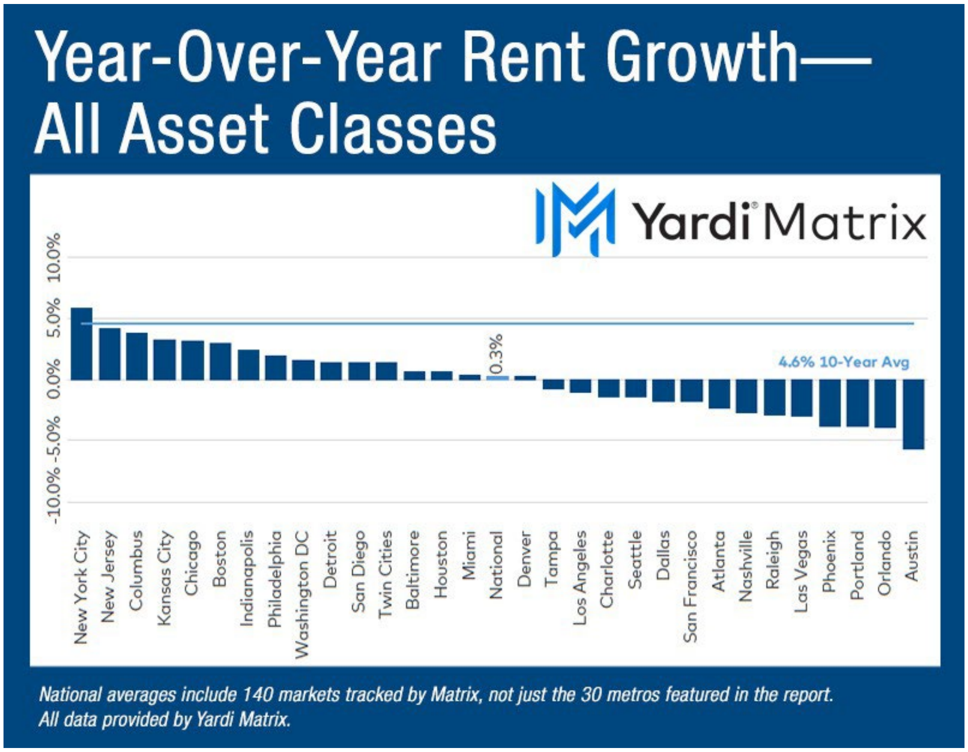
And, of course, not all markets are created equal. On the single-family front, the "hottest" markets for 2024, according to Zillow, include Buffalo, Cincinnati, Columbus, and Indianapolis, markets which have been mostly left behind in recent years. In fact, I can't recall seeing the words "hot," "Buffalo," and "Cincinnati" in the same sentence before, except during some NFL Playoff game. I gather it mostly comes down to affordability, as the median home prices in each of these cities are far lower than the national average, and the reality that these cities have been "left behind" in recent years in terms of economic and population growth.

Meanwhile, the WSJ released its annual list of the top "emerging" housing markets this fall, which are (drum roll, please): Topeka, Kansas; Elhart-Goshen, Indiana; Oshkosh-Neenah, Wisconsin; Fort Wayne, Indiana; and Lafeyette-West Lafayette, Indiana. At least the WSJ didn't say that the Topeka housing market is "hot," but that might change this year, so stay tuned.

Perhaps the biggest news regarding the single-family market, in a shot heard round the world (or at least in every single-family residential brokerage office), jurors in Missouri found the National Association of Realtors guilty of anticompetitive behavior, awarding home sellers $1.8 billion in damages. While I am sure the case will be appealed, one has to wonder whether this is merely an initial shot across the bow and whether those oligopolistic and sticky 4-6% commissions are finally at risk, or whether there are some idiosyncrasies in the Missouri market or laws? In any case, we have witnessed transaction costs declining across virtually every asset class over the last 30 years due to technology, while the fees and costs to buy or sell real estate have remained stubbornly high…and excessive, in my view. Maybe, at long last, the real estate brokerage industry is finally going to be disrupted, with those lofty commissions going the way of the Dodo bird. I am not holding my breath, but we shall see.

One other housing-related anecdote caught my attention towards the end of the year. Obviously, the economic and housing challenges of downtown San Francisco have been well documented. Consider one example, a high-end condominium close to City Hall, which sold for $1.25 million in 2019, in perhaps what can now be considered the "good old days." Well, following the pandemic and growing homelessness and lawlessness in the area (who knew you actually are supposed to pay for items at CVS, Walgreens, or Safeway?), that same condominium is listed for $769,000, and there seem to be no takers. However, away from its troubled districts, the San Francisco and Bay Area housing markets are otherwise doing very well, with prices having risen 3% in San Francisco last year and 8% in San Jose. The story is similar across many markets: pockets of price weakness, but surprising overall strength.

In the multifamily market, year-over-year rent growth was highest in New York City (up 5.9% in 2023), recovering from its Covid-related downturn, while Austin's rent declined the most (down 5.7%).



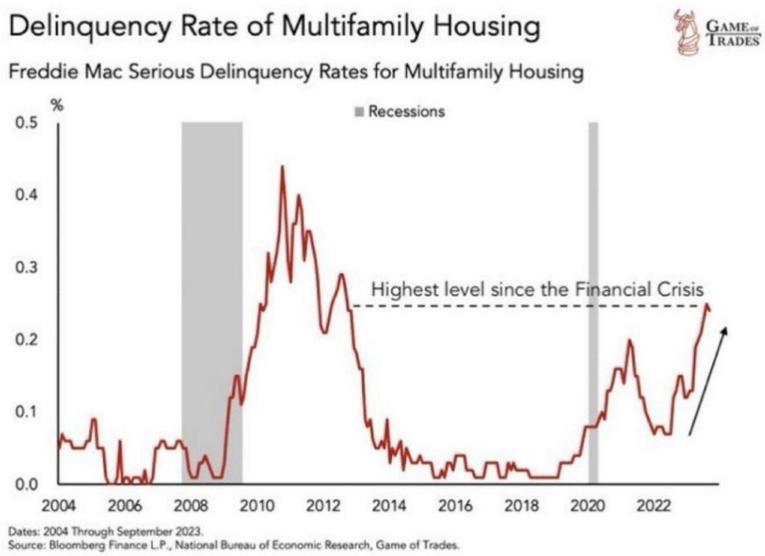
From a different perspective, the fastest growing markets for apartment renters include Huntsville, Alabama, Sioux Falls, South Dakota, and Lakeland, Florida. Who would have guessed?

Top 15 Fastest-Growing Markets for Apartment Renters

Rank	Market	YoY % Growth in Number of Apartment Renting Households
1	Huntsville, AL	15.1%
2	Sioux Falls, SD	8.4%
3	Lakeland, FL	7.5%
4	Port St. Lucie, FL	6.7%
5	Nashville, TN	5.8%
6	Salt Lake City, UT	5.4%
7	Colorado Springs, CO	5.3%
8	Charlotte, NC	5.1%
9	Raleigh/Durham, NC	5.1%
10	Pensacola, FL	5.0%
11	Myrtle Beach, SC	5.0%
12	Wilmington, NC	4.9%
13	Austin, TX	4.2%
14	Savannah, GA	4.2%
15	Jacksonville, FL	3.7%

Source: RealPage Market Analytics REALPAGE

While the fundamentals surrounding multifamily housing remain promising (single-family homes reman out of reach for most), with rents and occupancy rates poised to rebound later this year and next, that is not to say that the industry is not stressed as a result of rising interest rates and cap rate expansion, and nobody in the industry is entirely immune. According to Freddie Mac, delinquencies are rising and are at their highest levels since the Great Recession nearly 15 years ago.



Before we leave housing related news, I wanted to share a couple of forecasts regarding housing starts, rental growth, and occupancy levels, again from the same cast of characters mentioned earlier (no, not the psychics). Directionally, all agree, with new starts dropping sharply, as expected, and rents and occupancy levels marginally improving. I generally agree with these forecasts, though I think overall effective rent growth may be a tad softer than anticipated in 2024 as new projects begin aggressive lease-up efforts and boost occupancy through expanded concessions.

2024 Housing Starts Forecasts

Thousands, year-over-year percent change

	Single-family		Multifamily*		Total	
	Starts	% Chg	Starts	% Chg	Starts	% Chg
Fannie Mae	874	-4.5%	357	-24.0%	1,231	-11.2%
National Association of Home Builders (NAHB)	946	3.7%	386	-17.4%	1,333	-3.0%
Moody's Analytics	892	-1.5%	414	-12.8%	1,306	-5.4%
Mortgage Bankers Association (MBA)	1,025	10.6%	333	-28.4%	1,358	-2.5%

*Properties with 2 or more units

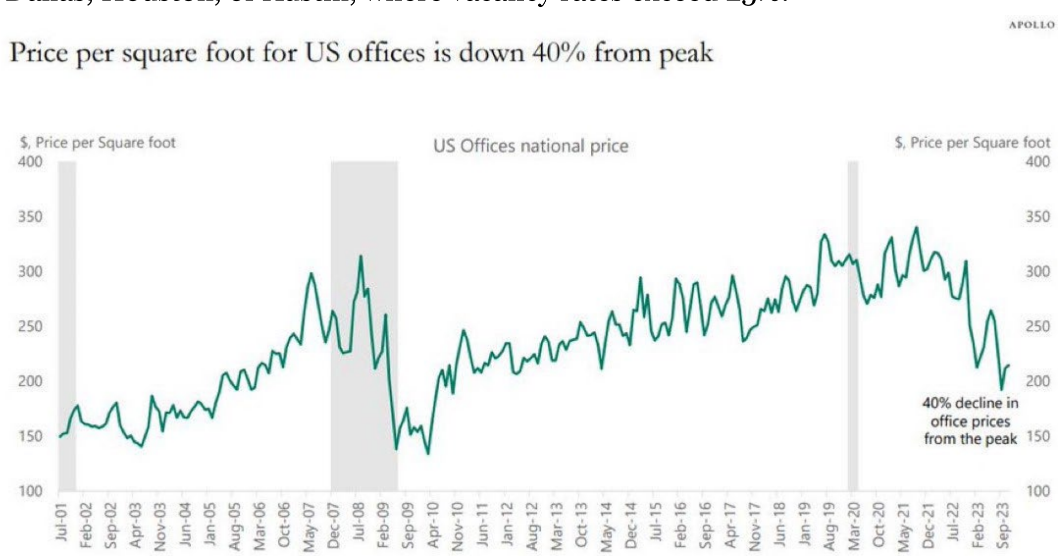
Occupancy & Effective Rent Growth Forecasts

	2023		2024		2025	
	Occupancy Rate	Effective Rent Growth	Occupancy Rate	Effective Rent Growth	Occupancy Rate	Effective Rent Growth
CoStar	92.5%	0.1%	92.5%	3.7%	92.7%	4.0%
RealPage	94.4%	1.7%	94.7%	2.5%	94.8%	2.9%
Yardi Matrix *	95.1%	2.9%	94.7%	2.8%	94.9%	3.8%

*Asking Rents

Now that you have made it this far, here is the bonus part of the quarterly memo, like CVS Extra Bucks: "Read 20 pages, get five more."

- **The Office Dumpster Fire Continues to Burn**: In news surprising absolutely no one, the office market continues to well, implode, with rising vacancies, declining rents, and foreclosures. Prices are down 40% from their peaks and anecdotes of distress dot the news almost daily. At last glance, the national vacancy rate approximated 20% and that figure will increase n coming months as existing leases roll. I sure wouldn't want to own office buildings in Dallas, Houston, or Austin, where vacancy rates exceed 25%.



Here are a few recent office-related headlines, which pair well with any intoxicant:

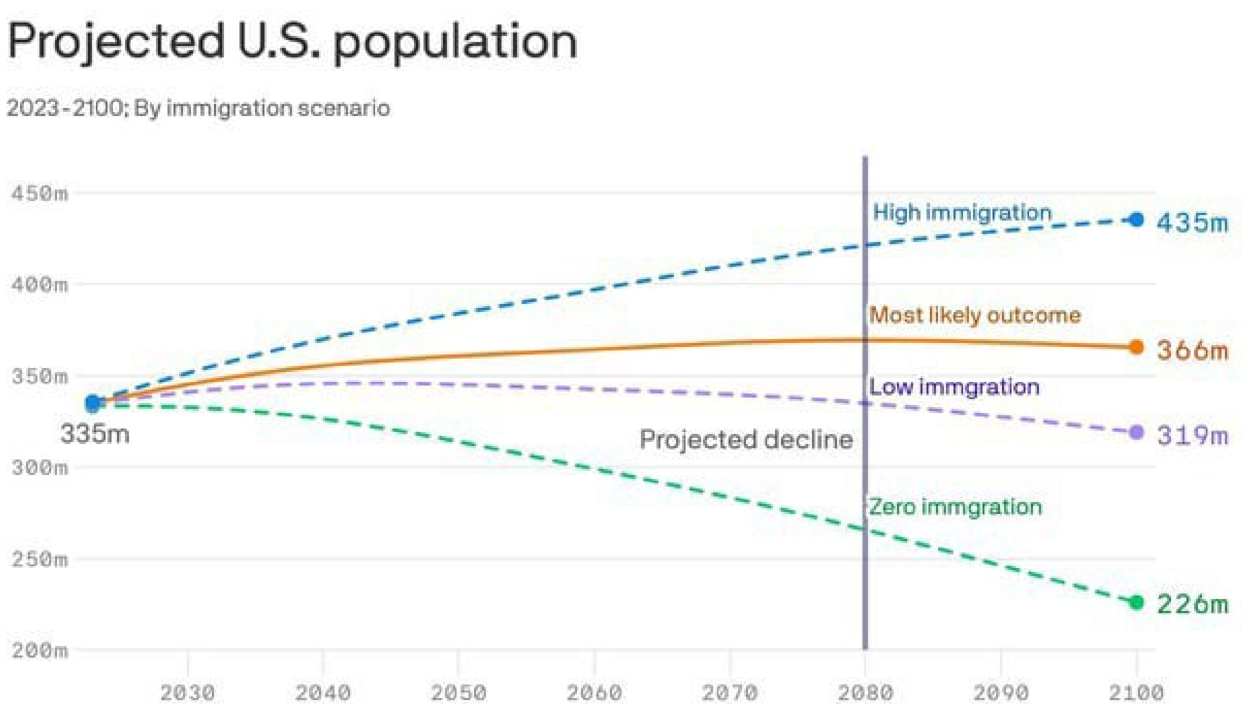
- **"Distressed West LA Office Building Sells For Half Its Pre-Covid Price"**: Westwood Terrace a nearly 165,000 square foot building in Westwood, right in our backyard, sold for about $45 million a mere two weeks ago. It was last acquired for $92.5 million by Goldman Sachs in August 2018.

- **"Chrysler Building's Fate Is Uncertain After Co-Owner Is Forced to Sell"**: The Chrysler Building, one of NYC's landmark buildings, will be sold after an Austrian court ruled that Signa Holding had to sell its stake in the building as part of a restructuring. The news followed Signa's insolvency (bankruptcy, essentially) filing in Austria this past November. If there is a poster child for the office market challenges, it could be the Chrysler Building, which sold for over $800 million in 2008 (buyer was Abu Dhabi) and to Signa for $150 million in 2019. Ouch.

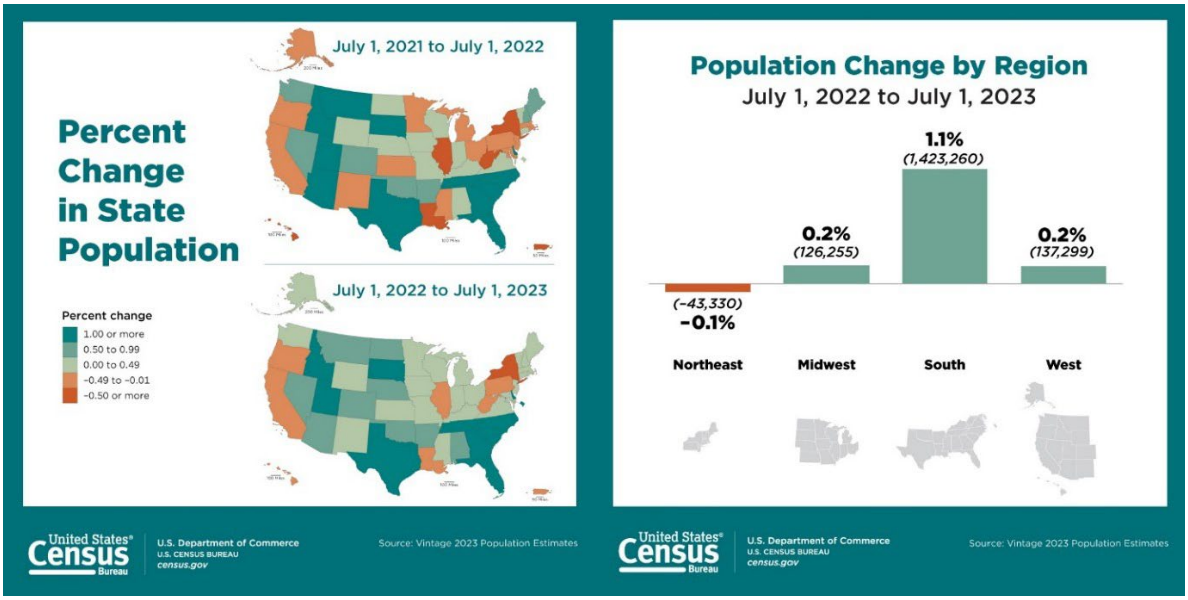
- **"Alexandria sells South Boston sites for barely half $169M purchase price":** In late December, Alexandria Real Estate Equities sold two sites in Boston that it had acquired in November 2020 for $168.5 million with an ambitious redevelopment plan, only to scrap the plan less than three years later, finally selling the assets at year end.

- **"Bankrupt WeWork to Immediately Dump 40 NYC Office Leases"**: WeWork entered Chapter 11 Bankruptcy in early November, finally concluding that WeDon'tWork. It is hard to fathom that the company was once valued at almost $50 billion.

- **Demographic Information Continues to Provide Material and Relevant Data to the Financial and Property Markets**: Over the years, I have written extensively how changing U.S. demographics are going to impact the financial and property markets, including wealth inequality (see above), declining marriage, birth rates, and population growth, as well as migration from the coasts inland (Manifest Destiny in reverse). Well, according to the most recent data, the U.S. population is set to shrink by 2100. You will note that the big variable is immigration and unless you have been living under a rock, we know how that political football is being handled.



Meanwhile, South Carolina and Florida grew fastest in 2023, as Southern states saw the largest population inflows, while California lost about 750,000 folks, including some of its wealthier residents seeking lower taxes. California budget analysts project a $68 billion deficit this year because of an anticipated 25% decline in individual tax collections.



- **Perhaps Twain Was Right and Youth Really Is Wasted on the Young**: At the end of the last quarterly memo, I commented briefly on the ongoing craziness on our college campuses, where I happen to spend a decent amount of time as a long-time UCLA Anderson School of Management faculty member (almost 30 years, as most of you know). Anyhow, a couple of recent polls shocked me. In one, conducted by the Economist, some 20% of people aged 18-29 here in the U.S. believe that the Holocaust is a myth. 20% and a myth! Such active denial is far more sinister than mere ignorance or a lack of education. An even larger percentage believe that the Holocaust has been "exaggerated" and that Jews have "too much power in America."

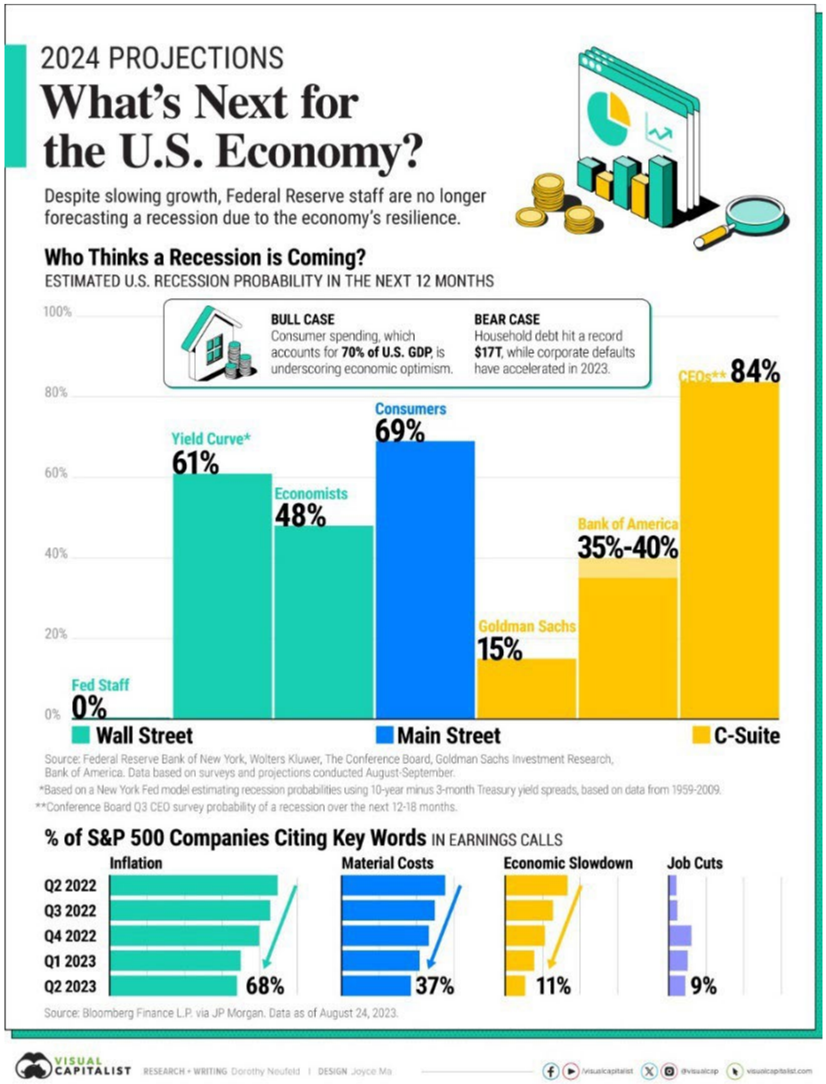
Another survey of protesting students at five different college campuses commissioned by the WSJ indicated that less than half could identify the relevant river or sea from their chant despite nearly 90% indicating their support for it. Less than a quarter of them knew who Yasser Arafat was or what the Oslo Accords were about. The lack of understanding - historical, geographic, and demographic – is deep…and troubling.

But there is hope. After survey respondents were shown a map and what "from the river to the sea" means vis a vis Israel, over two-thirds went from "supporting" the chant to "rejecting it." My sense is that student protests reflect youthful angst, pessimism, and a lack of education as much as anything else. Gen-Z is rightfully concerned about the cost of housing, education, and related debt levels, an uncertain and changing job market, AI, geopolitical unrest, political divisions, and social media, concerned that they will be materially worse off than the generation that preceded them. As is often the case, dialogue and education remain the likely solution.

In closing, 2024 will be an extremely important year, as we (hopefully) obtain eagerly awaited clarity regarding inflation, interest rates, geopolitical conflicts, commercial real estate values, and our political future.

In my career, I cannot recall a market where there was so much uncertainty and conflicting data about so many different things. Sure, the memories of many market downturns remain close at hand (1989-1992 recession, the 1998 global financial crisis, the dot-com implosion, the Great Recession, and Covid), but today, so much remains uncertain about everything from the health of the consumer, the direction of and future for the labor markets, inflation and interest rates, geo- and national politics, the future of the office and housing markets, the value of a college (and graduate level) education, etc.

Perhaps this chart says it best, even more clearly than the earlier forecasts I provided from various market participants. When asked as to the probability of a recession in 2024, 84% of C-suite executives believe one is coming versus nary a single member of the Fed. Consumers (69%), various investment banks (15-40%), and economists (48%) find themselves in-between. Long story, short? Consensus is nowhere to be found.



While I am absolutely convinced that the future of housing in the U.S. and globally lay in higher density, multifamily assets, Clear Capital and its competitors will need to work through the significant headwinds of increased supply, higher interest rates, expiring interest rate caps, and upcoming debt maturities, and we are very focused on doing so, and we remain grateful for your support in the process.

Perhaps Rod Serling said it best, with some appropriate edits and insertions: "There is a fifth dimension beyond that which is known to man, economists, or market forecasters. It is a dimension as vast as space and as timeless as infinity. It is the middle ground between light and shadow, between science and superstition, and it lies between the pit of man's fears and the summit of his knowledge. This is the dimension of imagination. It is an area which we call the U.S. economy in 2024, or during various holidays and television marathons, The Twilight Zone."

Finally, in what is a Q4 newsletter tradition, I will wrap up this memo with some additional musings from two of my favorite philosophers and literary companions, Calvin & Hobbes:

With that, the entire Clear Capital team and I hope that you had wonderful holiday seasons and that 2024 is a healthy and prosperous year for you and yours. Again, thank you for your ongoing support, for which I remain appreciative and grateful.

Best,

Eric Sussman
Managing Partner

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