“Lately, it occurs to me…what a long, strange trip it’s been.”
- Grateful Dead

“When life gives you lemons, make lemonade. Then find someone with vodka and have a party.”
- Ron White

Last week, while making a rare visit to a traditional shopping mall (fear not, Costco, my singular devotion to you remains intact), I decided to enter one of those Halloween pop-up stores that rise like phoenixes around this time of year. While I can’t recall the last time I donned a costume for a themed party or to trick-or-treat, Halloween was, without question, my favorite holiday growing up. Let’s face it, whoever invented the idea of handing out copious quantities of free candy to kids dressed in costumes – I suspect it was the American Dental Association, in partnership with Disney - deserves the Nobel Prize, my sincere gratitude, and blame for my few mercury-based fillings.

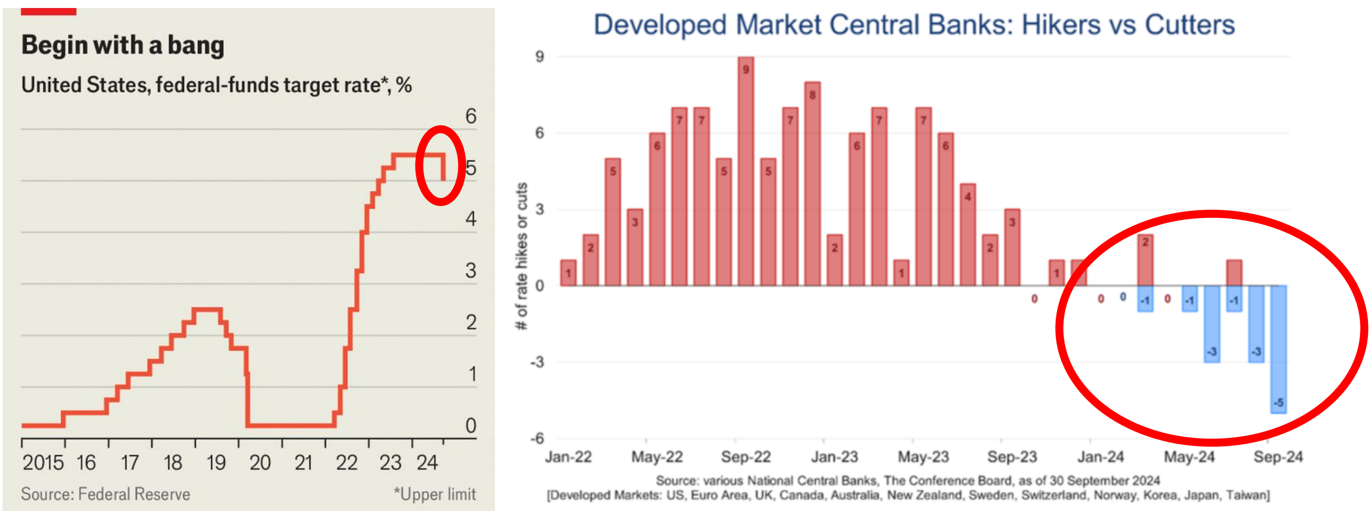
Anyhow, I couldn’t help but note that many of the long-time classic masks and costumes are still popular: Freddie Krueger, Chuckie Ray, Michael Myers, and a Trump favorite, Hannibal Lecter, all horror movie icons. I think you might recognize these handsome “devils.”

However, not only are these costumes dated, but if I really wanted to dress up as someone far more frightening and powerful, whose every word, utterance, or action drive fear, terror, and angst across the globe, materially impacting markets and investment portfolios, my costume choice would be easy: Jerome Powell, who just starred in a gripping third quarter horror film and Oscar contender, “The Fed, 2024: Cut or Not?” While this production which may not yet compete with “Halloween 20” for “horror film” status, that could certainly change in the coming quarters.

While few would probably recognize me or my costume, Mr. Powell has indeed left us with a scary set-up. While most predict that the Fed will guide us to a "soft landing," significant economic, political, and market risks lurk everywhere and it is nearly impossible to predict what 2025 might bring.

Specifically, despite equity markets trading at or near record highs, the economy experiencing full, or nearly full-, employment, and the Fed's 2.0% inflation target still proving a bit illusive (see below), the Fed surprised most market pundits by cutting rates by 50 basis points last month, answering the most pressing question since we wondered "who killed J.R.?" (his sister-in-law), "did Lee Harvey Oswald act alone?" (ask Oliver Stone), or "when will the Mets and Tigers make the playoffs again?" (2024!).

Most market observers and those so-called "professional" economists were generally predicting a more modest 25 basis point move. Other central banks have joined in the fun, with eight of the 10 major developed-market central banks beginning to ease this year. Japan is the only outlier, as they recently raised rates, which sent global markets into a tizzy at the start of the third quarter (see below). The ECB reduced rates in June for the first time since Covid. In July, the Bank of England voted to do the same, joining Canada, Chile, Denmark, and others.



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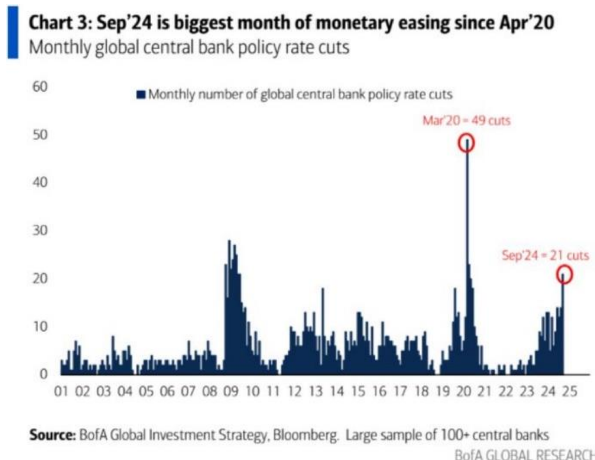
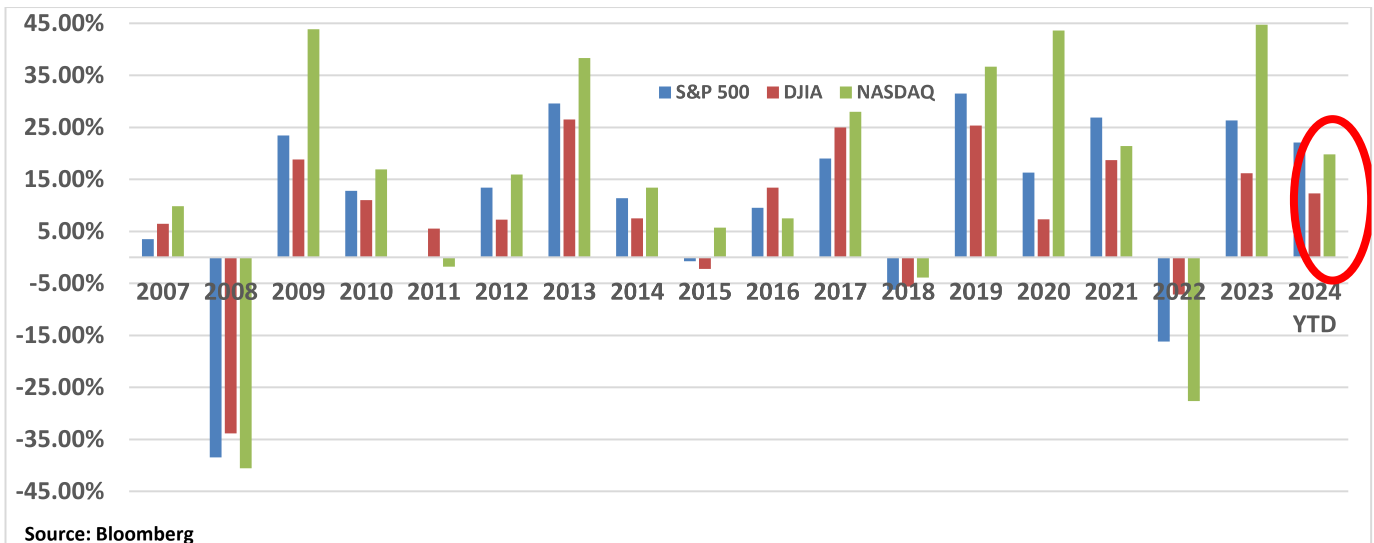
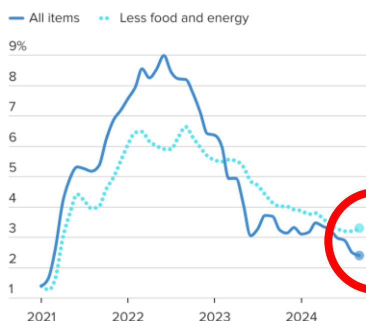
In total, September of 2024 saw a total of 20 rate cuts amongst all central banks.

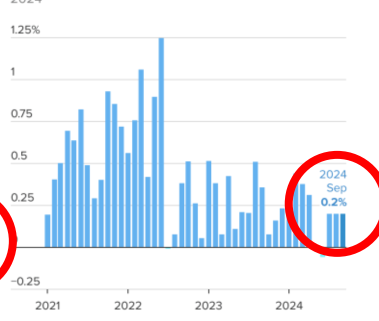


The result? Yet another stock market rally, with the S&P 500 rising 1.7% on the day following the Fed announcement, and the markets have not looked back since. The S&P 500 is up over 23% in 2024, nearly 35% over the past 12 months, and nearly 7% in just the past month alone. Does that sound recessionary or deflationary?



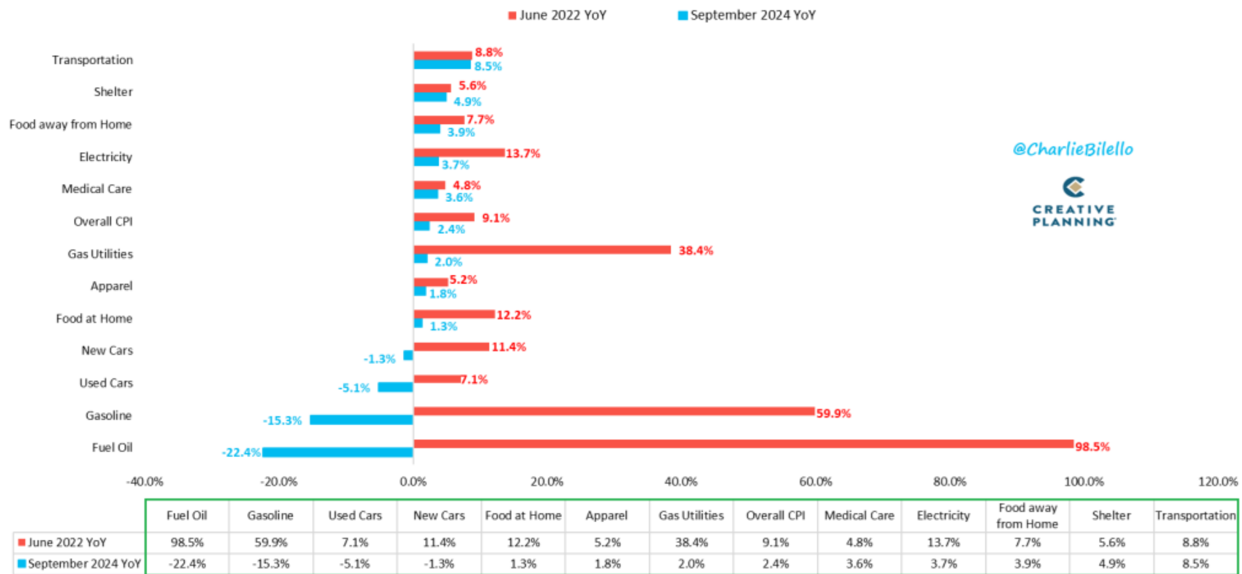
Unfortunately, and perhaps ironically, Treasury yields and mortgage rates have spiked since the Fed cut, in response to higher-than-expected inflation and stronger than expected job figures. While the Consumer Price Index (CPI) increased to 2.4% in September, year-over-year, slightly higher than expected "core" CPI (aggregate prices on typical goods, excluding volatile food and energy) was up 3.3%, the first increase since March 2023.





A closer look at the September inflation data is a mixed bag. On the one hand, gas prices were down 15% from a year ago. On the other hand, there were some lingering trouble spots, including car insurance (up 16% year-over-year), transportation services (up 8.5%) and groceries (up 0.4% in September, month-over-month). Shelter costs continue to moderate as predicted, up 4.9% over the past year, but are still additive to reported inflation.

YoY % Change (June 2022 vs. September 2024 CPI Reports)

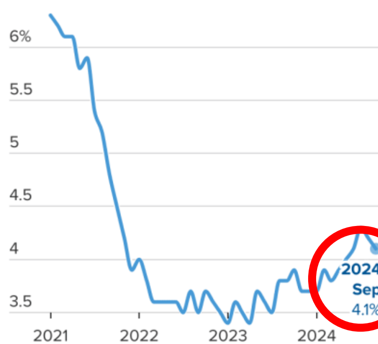


	Fuel Oil	Gasoline	Used Cars	New Cars	Food at Home	Apparel	Gas Utilities	Overall CPI	Medical Care	Electricity	Food away from Home	Shelter	Transportation
June 2022 YoY	98.5%	59.9%	7.1%	11.4%	12.2%	5.2%	38.4%	9.1%	4.8%	13.7%	7.7%	5.6%	8.8%
September 2024 YoY	-22.4%	-15.3%	-5.1%	-1.3%	1.3%	1.8%	2.0%	2.4%	3.6%	3.7%	3.9%	4.9%	8.5%

Then, just a couple of Fridays ago, the Labor Department indicated that employers added 254,000 jobs in September, the highest figure reported this year, significantly surpassing expectations (around 150,000,). The Labor Department also revised July and August job figures upwards by 72,000, following months of downward revisions and surprises to the downside. The unemployment rate dipped slightly, to 4.1%. Job gains principally occurred in bars, restaurants, construction, government, education, and healthcare.

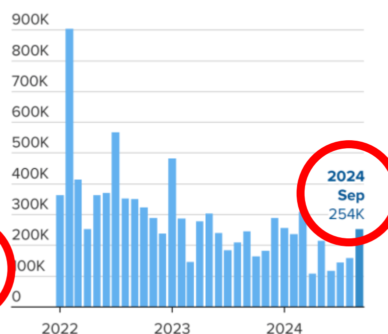
Talk about a head fake. The much stronger than expected labor data caught everyone flatfooted, perhaps even our modern-day Chuckie, Jerome Powell.

U.S. unemployment rate
January 2021–September 2024



Source: U.S. Bureau of Labor Statisitics
Data as of Oct. 4, 2024
CNBC

Monthly job creation in the U.S.
January 2022–September 2024



Source: U.S. Bureau of Labor Statistics via FRED
Data as of Oct. 4, 2024
CNBC

What's so bad about strong labor markets? Generally nothing whatsoever, of course, but it has been weaker labor markets and repeated downward revisions to employment data that have provided necessary cover to the Fed - along with moderating inflation - to reduce interest rates.

With the recent employment data, the Fed will feel less pressure to reduce rates going forward, at least for the time being. Yields on 10-year Treasuries jumped from around 3.65% to 4.10% and 30-year fixed rate mortgage rates increased from less than 6.1% to about 6.50% following the eye-popping job numbers.

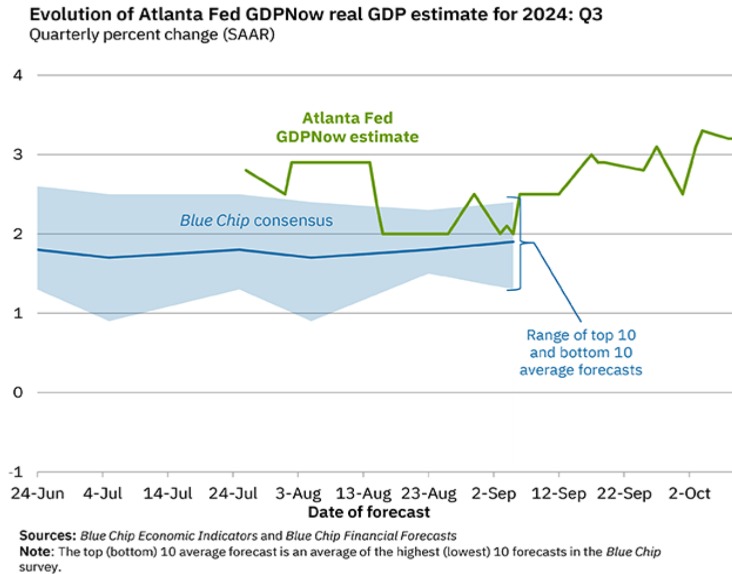
Just when prospective homebuyers, commercial real estate participants (including your friends at Clear Capital), and lenders (especially regional and community center banks) were hoping for lower rates and less interest rate volatility, some of that optimism has been dashed, which, again, may be temporary. Keep in mind that more than $2.2 trillion in commercial-property debt is coming due between now and 2027, and commercial real estate values have been badly wounded by higher rates and numerous other headwinds discussed in recent memos.

Despite all the rhetoric about how bad the economy is, perhaps predictable election year rhetoric, the data tells a different story. From Bitcoin to bonds, from gold to equities, from gold to other commodities, virtually all asset classes have witnessed positive returns this year, something we haven't seen since 2019. I think only Intel's stock price and UCLA's football record are down this year, or so it seems.

CREATIVE PLANNING — Asset Class Total Returns Since 2011 (Data via YCharts as of 9/24/24) — @CharlieBilello

ETF	Asset Class	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2011-24 Cumulative	2011-24 Annualized
N/A	Bitcoin ($BTC)	1473%	186%	5507%	-58%	35%	125%	1331%	-73%	95%	301%	66%	-65.5%	155.8%	**52.0%**	142579[illegible]%	144.8%
GLD	Gold	9.6%	6.6%	-28.3%	-2.2%	-10.7%	8.0%	12.8%	-1.9%	17.9%	24.8%	-4.2%	-0.8%	12.7%	**28.7%**	77.4%	4.3%
IWF	US Growth	2.3%	15.2%	33.1%	12.8%	5.5%	7.0%	30.0%	-1.7%	35.9%	38.3%	27.4%	-29.3%	42.6%	**24.0%**	663.9%	16.0%
SPY	US Large Caps	1.9%	16.0%	32.2%	13.5%	1.2%	12.0%	21.7%	-4.5%	31.2%	18.4%	28.7%	-18.2%	26.2%	**21.3%**	485.2%	13.8%
QQQ	US Nasdaq 100	3.4%	18.1%	36.6%	19.2%	9.5%	7.1%	32.7%	-0.1%	39.0%	48.6%	27.4%	-32.6%	54.9%	**19.0%**	910.0%	18.4%
IWD	US Value	0.1%	17.5%	32.1%	13.2%	-4.0%	17.3%	13.5%	-8.5%	26.1%	2.7%	25.0%	-7.7%	11.4%	**15.7%**	295.7%	10.6%
VNQ	US REITs	8.6%	17.6%	2.3%	30.4%	2.4%	8.6%	4.9%	-6.0%	28.9%	-4.7%	40.5%	-26.2%	11.8%	**14.3%**	204.1%	8.5%
EEM	EM Stocks	-18.8%	19.1%	-3.7%	-3.9%	-16.2%	10.9%	37.3%	-15.3%	18.2%	17.0%	-3.6%	-20.6%	9.0%	**14.0%**	27.3%	1.8%
MDY	US Mid Caps	-2.1%	17.8%	33.1%	9.4%	-2.5%	20.5%	15.9%	-11.3%	25.8%	13.5%	24.5%	-13.3%	16.1%	**13.2%**	310.6%	10.9%
EFA	EAFE Stocks	-12.2%	18.8%	21.4%	-6.2%	-1.0%	1.4%	25.1%	-13.8%	22.0%	7.6%	11.5%	-14.4%	18.4%	**12.2%**	113.8%	5.7%
PFF	Preferred Stocks	-2.0%	17.8%	-1.0%	14.1%	4.3%	1.3%	8.1%	-4.7%	15.9%	7.9%	7.2%	-18.2%	9.2%	**12.0%**	90.2%	4.8%
IWM	US Small Caps	-4.4%	16.7%	38.7%	5.0%	-4.5%	21.6%	14.6%	-11.1%	25.4%	20.0%	14.5%	-20.5%	16.8%	**10.8%**	241.0%	9.4%
EMB	EM Bonds (USD)	7.7%	16.9%	-7.8%	6.1%	1.0%	9.3%	10.3%	-5.5%	15.5%	5.4%	-2.2%	-18.6%	10.6%	**8.5%**	64.5%	3.7%
HYG	High Yield Bonds	6.8%	11.7%	5.8%	1.9%	-5.0%	13.4%	6.1%	-2.0%	14.1%	4.5%	3.8%	-11.0%	11.5%	**7.8%**	90.4%	4.8%
CWB	Convertible Bonds	-7.7%	15.9%	20.5%	7.7%	-0.8%	10.6%	15.7%	-2.0%	22.4%	53.4%	2.2%	-20.8%	14.5%	**6.5%**	220.1%	8.9%
LQD	Investment Grade Bonds	9.7%	10.6%	-2.0%	8.2%	-1.3%	6.2%	7.1%	-3.8%	17.4%	11.0%	-1.8%	-17.9%	9.4%	**5.6%**	68.5%	3.9%
TIP	TIPS	13.3%	6.4%	-8.5%	3.6%	-1.8%	4.7%	2.9%	-1.4%	8.3%	10.8%	5.7%	-12.2%	3.8%	**5.2%**	45.0%	2.7%
BND	US Total Bond Market	7.7%	3.9%	-2.1%	5.8%	0.6%	2.5%	3.6%	-0.1%	8.8%	7.7%	-1.9%	-13.1%	5.7%	**4.9%**	36.9%	2.3%
BIL	US Cash	0.0%	0.0%	-0.1%	-0.1%	-0.1%	0.1%	0.7%	1.7%	2.2%	0.4%	-0.1%	1.4%	4.9%	**3.9%**	15.8%	1.1%
DBC	Commodities	-2.6%	3.5%	-7.6%	-28.1%	-27.6%	18.6%	4.9%	-11.6%	11.8%	-7.8%	41.4%	19.3%	-6.2%	**2.5%**	-10.9%	-0.8%
TLT	Long Duration Treasuries	34.0%	2.6%	-13.4%	27.3%	-1.8%	1.2%	9.2%	-1.6%	14.1%	18.2%	-4.6%	-31.2%	2.8%	**2.4%**	50.6%	3.0%
Highest Return		BTC	BTC	BTC	VNQ	BTC	BTC	BTC	BIL	BTC	BTC	BTC	DBC	BTC	BTC	BTC	BTC
Lowest Return		EEM	BIL	GLD	BTC	DBC	BIL	BIL	BTC	BIL	DBC	TLT	BTC	DBC	TLT	DBC	DBC
% of Asset Classes Positive		62%	95%	52%	71%	38%	100%	100%	5%	100%	90%	67%	10%	95%	100%	95%	95%

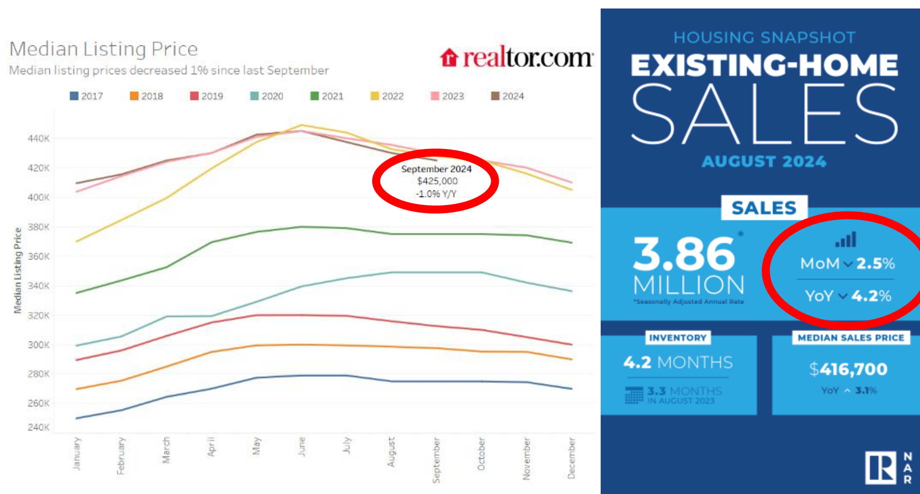
Meanwhile, the Atlanta Fed predicts that the U.S. economy (real GDP) grew by 3.2 percent in the third quarter, about 0.7% higher than they were predicting a mere month ago. Recession schmecession.



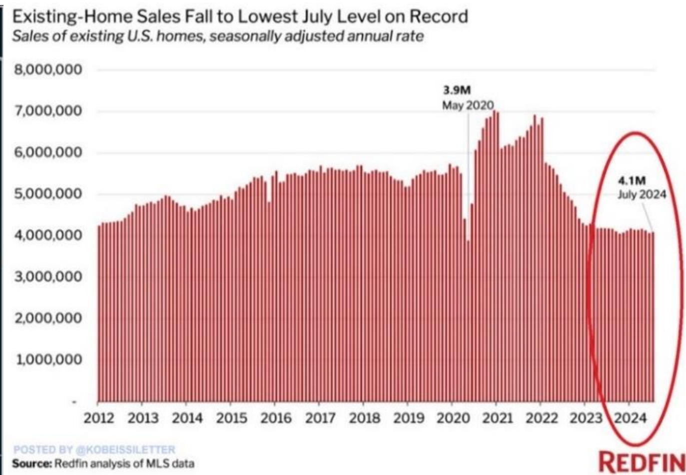
In any case, it's not easy to reconcile the positive data with all the dystopian political rhetoric and craziness we witnessed in the third quarter and into October: two hurricanes, expanding conflict in the Middle East, two assassination attempts on our former president, the aforementioned Detroit Tigers overcoming 500-to-1 odds to make the playoffs, and claims about migrants eating household pets. Confucious said that we should "live in interesting times," and indeed, we do. The word "unprecedented" is all-too commonly used these days, and not without good reason. Or maybe "weird" is indeed the best word to describe current events.

So, what did the third quarter bring in terms of housing, both single- and multifamily?

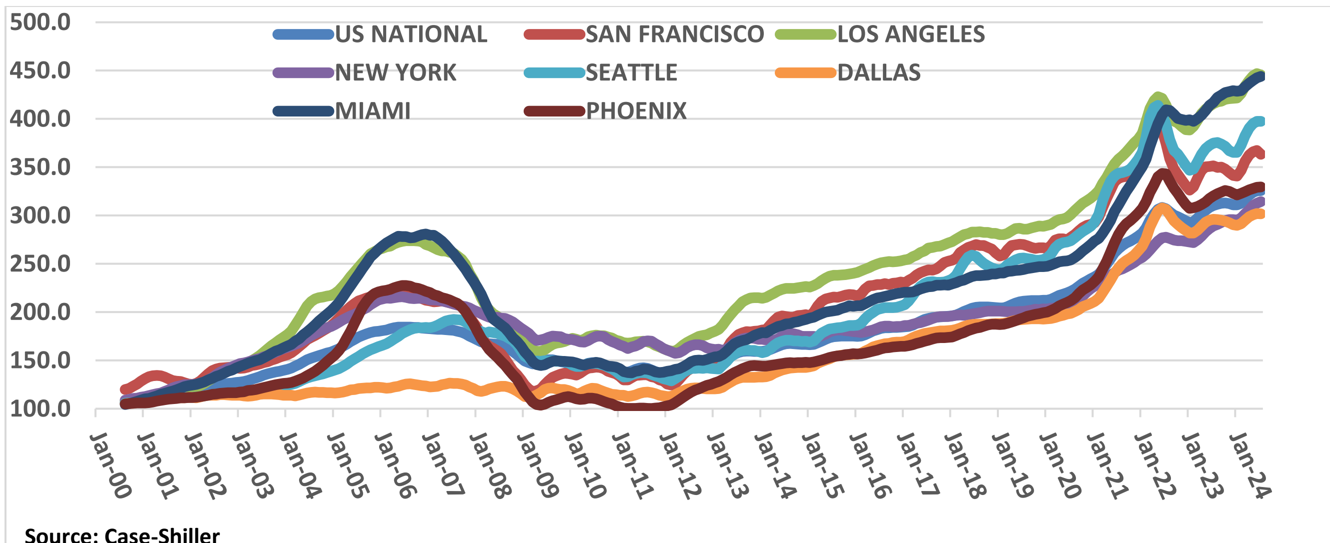
While single-family home prices were essentially flat during the third quarter (median listing prices were down 1.0% in September), transaction volume remains in the doldrums. New and active listings were up 8.0% and 33.2% in September, respectively, resulting in a sizable increase in available inventory for sale. August sales were down over 4.0%, year-over-year, the 36th straight year-over-year decline and the longest down streak in activity since 2006 to 2009. Ouch.



We can draw two takeaways from single-family housing market data. One, lower interest rates have not and are not spurring demand. In fact, mortgage demand stands at 30-year lows, with September mortgage applications matching levels last seen in 1994. July existing homes sales fell to the lowest levels on record. Perhaps, it is no surprise. A record 8.5% of homes in the U.S. are now valued at $1.0 million or more. Even at the $425K median listing price, prospective homeowners need to have at least six-figures plus in cash or liquid assets just to purchase a home, let alone meet daunting monthly mortgage obligations, impacted by both the higher prices and mortgage rates.

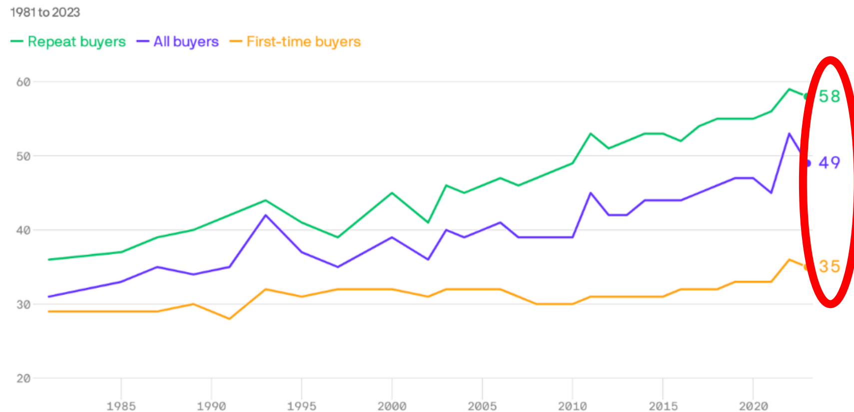


And two, while lower rates may not be lighting a fire under demand, home prices remain firm. Ever since the Great Financial Crisis, when home prices declined modestly, roughly 10% in nominal terms, they have seemed impervious to whatever slings and arrows come their way: COVID, higher interest rates, and significant limits on the deductibility of interest and property taxes for income tax purposes in the 2017 Tax Cuts and Job Act. Nationally, home prices were up about 4.7% through July and appear steady since then.

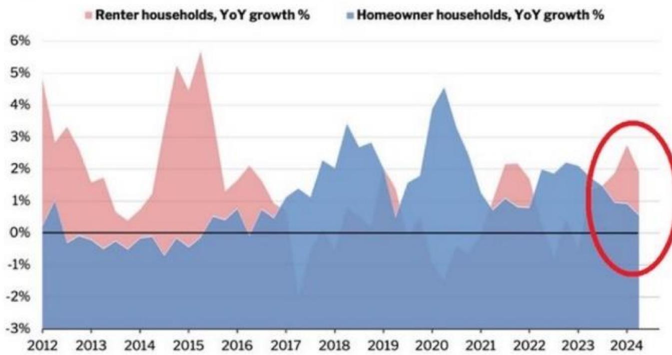


How does one explain these higher prices in the face of materially higher interest rates, mortgage costs, and general uncertainty? It goes back to a supply story, impacted by everything from land use restrictions, the lack of buildable lots, NIMBYism, poorly construed public and housing policy, and significantly shifting demographics. Without substantial additions to

housing supply and a more stable employment market for those under 40, prices are not likely to moderate and affordability are not likely to improve. Not surprisingly, the typical first-time homebuyer was 29 in 1984, according to a survey conducted by the National Association of Realtors (NAR) at the time. In their 2023 survey, the age of the median first-time home buyers rose to 35, a trend I expect to continue.



Today's housing market is the most difficult in decades, a great frustration for millennials and GenZers looking for their first homes. Home-buying affordability dropped last fall to the lowest level since September 1985, and it fell near that level again this past June. The net result is that the U.S. is adding far more renter households than homeowners:



The final material news from the third quarter impacting the single-family market surrounds the way real estate agents are compensated. You will recall that NAR reached a landmark legal settlement earlier this year over its commission structure, and by the end of the quarter, most of its members are subject to the new rules. Under the prior regime, the seller typically paid the agents on both sides of a transaction based on the listing agreement, usually 5% or 6% of the sale price, and the seller's agent split the commission with the buyer's agent.

The settlement compelled two significant changes in the way realtors conduct business. First, listings in local multiple-listing services (MLS) will no longer indicate whether a seller is offering to pay a buyer's agent, or how much. Second, buyers will be required to sign agreements specifying how much their agents will be paid before they start touring homes with agents. In theory, buyers will be able to negotiate directly with their agents, instead of letting the seller

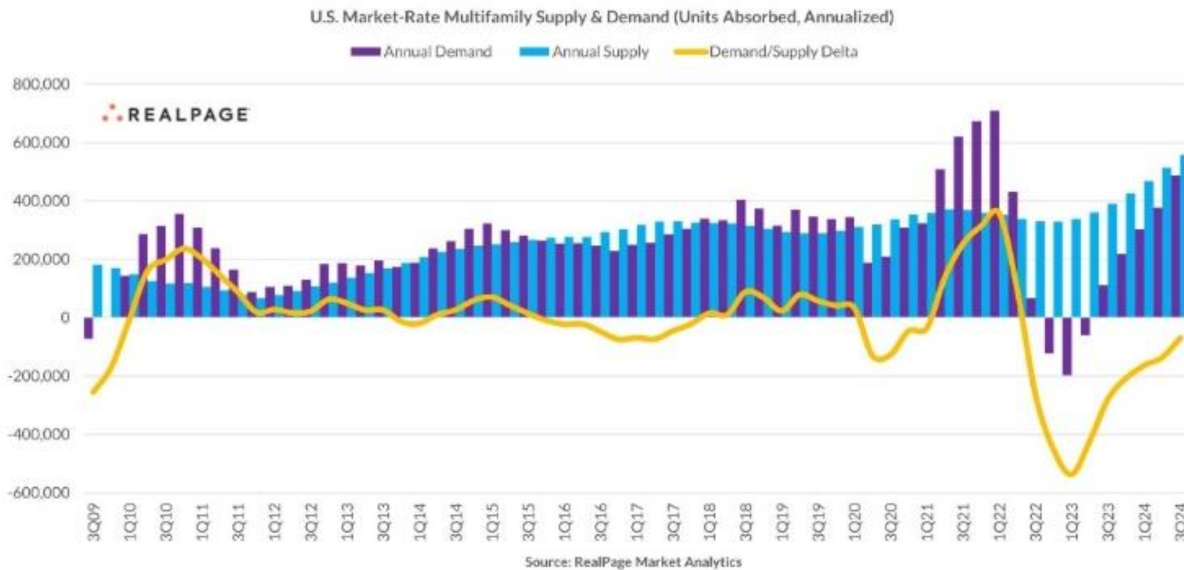
decide how much the buyer's representative earns. Whether the settlement ultimately impacts commission levels and/or transaction volumes remains to be seen. I know this will shock you, but color me a cynic.

And multifamily? Can we assume that sector has been benefitting significantly from single-family headwinds?

Well, "yes" and "no." On the one hand, the U.S. is adding more renter households, as discussed above, as first-time homebuyers (and others) simply cannot afford to purchase a new home, or perhaps are reluctant to make the necessary commitment in the face of so much economic, market, and labor market uncertainty. During the third quarter, renter demand remained solid, despite a surge in new supply, with the net result being flat rental growth across most of the U.S.

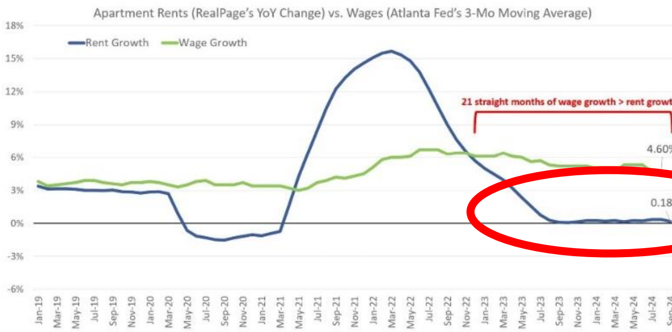
In the third quarter, 192,649 market-rate units were absorbed, while 162,595 new apartments were delivered, according to RealPage. Total 2024 supply hit 557,842 units, outpacing demand (488,773 units) by 69,000 units, the narrowest gap in two years, which I anticipate will narrow further in coming quarters. More apartments have been delivered thus far in 2024 than we have witnessed since 1974 and the Nixon/Ford administration. Due to declining construction starts, CoStar projects annual completions will drop to less than 350,000 units in 2025 and about 275,000 in 2026.

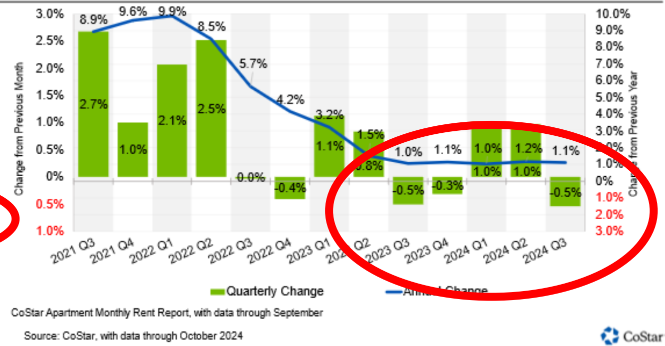
Meantime, the supply delivering today may be diminishing returns to both existing and prospective multifamily investors, but it is providing much-needed housing inventory. Nationwide, apartment occupancy stood at 94.4%, and average rent, $1,838 at and by the end of the quarter.



Increased demand for multifamily units has been driven by numerous factors: sustained, if not slowing job growth, the unaffordability of single-family homes, and increased wage growth (wage growth has outpaced rent growth for about two years). While increased demand has been met by even more robust supply, the construction pipeline is drying up rapidly. Nearly three-quarters of units currently under development should be delivered in the next 12 months. Come 2026 and 2027, annualized deliveries will be a fraction of current volumes.

However, the elevated supply is tempering what would otherwise be more robust rental growth. Rents grew by a whopping 0.18% in September, resulting in flat rents that have hovered for over a year.





Of course, digging deeper into the data is revealing. One, with wage growth exceeding rental growth for nearly two years, tenants ought to be able to afford higher rents, once the existing supply pipeline is absorbed, assuming single-family homes remain out of reach for so many. Two, while national rents were essentially flat, different markets have experienced differing rent growth (or declines), generally reflecting supply.

Those markets with the greatest supply – Jacksonville, Raleigh, Austin, Salt Lake City, Denver, Phoenix, Seattle, and Fort Worth – saw rental declines of over one percent last month, despite robust demand. Developers in these markets offer generous concessions to lure new tenants to their Class A, amenitized projects, which, in turn, places pressure on all other units in the market. Overall, rents declined in about a third of U.S. metro areas.

Top 20 Markets for Apartment Demand

Rank	Metro Area	T-12 Net Absorption (units)	Demand > Supply?
1	Dallas/Fort Worth, TX	33,196	No
2	Houston, TX	22,367	No
3	Phoenix, AZ	21,563	No
4	Austin, TX	21,460	No
5	Atlanta, GA	20,868	No
6	Denver, CO	15,156	No
7	Washington, DC	14,688	No
8	Northern New Jersey	13,355	No
9	Charlotte, NC	13,066	No
10	Raleigh/Durham, NC	12,715	No
11	New York, NY	12,438	No
12	Orlando, FL	12,025	No
13	Nashville, TN	11,408	No
14	Seattle, WA	10,833	No
15	Miami, FL	9,274	No
16	Tampa, FL	9,227	No
17	San Antonio, TX	8,877	No
18	Minneapolis, MN	8,672	No
19	Jacksonville, FL	8,105	No
20	Philadelphia, PA	7,975	No

Sources: Madera Residential research, RealPage. Data reflects net absorption for the year-ending September 2024.

Class C Rents are Falling Hardest in High-Supplied Markets

Rank	Metro Area	Supply Rate Above U.S. Avg?	Class C YoY Rent Change
1	Fort Walton Beach, FL	Yes	-13.5%
2	Austin, TX	Yes	-10.7%
3	Fort Myers, FL	Yes	-9.0%
4	Sarasota, FL	Yes	-8.6%
5	Phoenix, AZ	Yes	-6.6%
6	Daytona Beach, FL	Yes	-6.5%
7	Provo, UT	Yes	-5.7%
8	Salt Lake City, UT	Yes	-5.7%
9	Raleigh/Durham, NC	Yes	-5.6%
10	Atlanta, GA	Yes	-5.3%
11	Naples, FL	No	-5.3%
12	Greenville, SC	Yes	-5.2%
13	Jacksonville, FL	Yes	-5.0%
14	Colorado Springs, CO	Yes	-4.9%
15	Wilmington, NC	Yes	-4.8%
16	Tampa, FL	Yes	-4.5%
17	Palm Bay, FL	Yes	-4.3%
18	Dallas, TX	Yes	-4.3%
19	Charlotte, NC	Yes	-4.2%
20	Orlando, FL	Yes	-4.1%
21	Fort Worth, TX	Yes	-4.0%

Source: Madera Residential research, RealPage Market Analytics. Supply rate = year-over-year change in apartment inventory relative to U.S. average of 2.7% as of June 2024.

Meantime, markets like Buffalo, Lincoln, Kansas City, and Milwaukee – those developers have mostly ignored in recent years – were rental leaders, depending on the source. Nationally, 20 of the 21 top markets for rent growth are located in the Midwest or Northeast, continuing a pattern of low-supply markets achieving the most rental growth. The only exception was Honolulu.

Of the nation's 150 largest metro areas, only 17 produced apartment rent growth (year-over-year) of at least 4% year-over-year through August 2024 and all of them are secondary or tertiary markets with little institutional presence. In fact, among largest 50 multifamily markets, rent growth exceeded inflation in only Milwaukee, Washington DC, Kansas City, Cincinnati, Detroit, Chicago and Virginia Beach.

I will go out on a proverbial limb to suggest that nobody had Buffalo as the top apartment for rental growth in the third quarter on their 2024 bingo cards. And if anyone included Youngstown, Rochester, Hartford, and Dayton in their top 10 rental leaders, they deserve some sort of recognition or medal, perhaps a leftover from this summer's Paris Olympics, an extra peanut butter cup on Halloween, or just a participation trophy. These markets have experienced recent job growth, especially in manufacturing.

Apartment Rent Growth Leaders

Rank	Metro Area	YoY Rent Change
1	Buffalo, NY	6.36%
2	Lincoln, NE	6.12%
3	New Haven, CT	5.76%
4	Youngstown, OH	5.75%
5	Lansing-East Lansing, MI	5.16%
6	Rochester, NY	5.13%
7	Hartford, CT	5.03%
8	Syracuse, NY	4.98%
9	Dayton, OH	4.96%
10	Champaign-Urbana, IL	4.55%
11	Columbus, GA	4.46%
12	Providence, RI	4.43%
13	Lexington, KY	4.34%
14	Portland, ME	4.22%
15	Omaha, NE	4.17%
16	Louisville, KY	4.12%
17	Honolulu, HI	4.01%

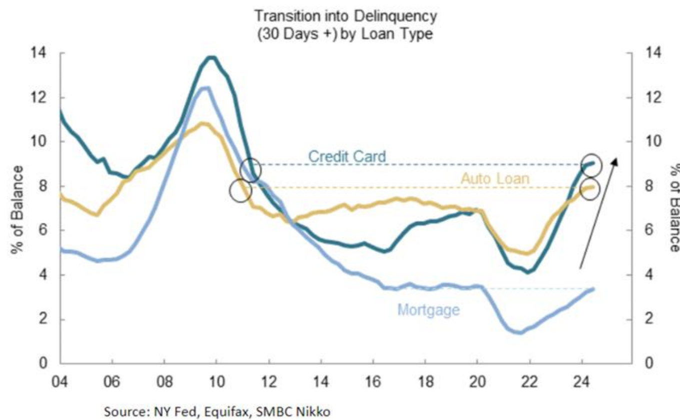
Data reflects year-over-year same-store store change in effective rents for new leases in market-rate apartments as of August 2024.
Source: Madera Residential research, RealPage Market Analytics.

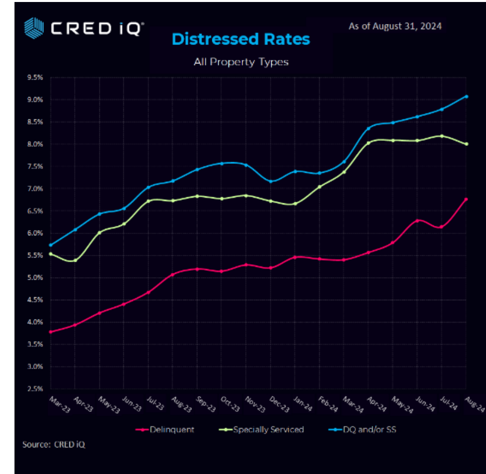
However, cracks are beginning to emerge in certain parts of the multifamily market, especially amongst participants who borrowed heavily using floating-rate debt as part of their value-add strategies

It will likely come as no surprise that more than $40 billion of office loans were in distress at the end of the second quarter according to MSCI, roughly three times the value of distressed apartment loans. However, the pool of apartment mortgages that could get into difficulty in the future is far larger, $56.9 billion, versus approximately $51 billion of office loans at risk. The distress rate on commercial real estate collateralized loan obligations (CLOs), which includes any loan 30-days delinquent (or more), past maturity (and still outstanding, of course), or in special servicing reached 10.8%. As most CLOs have three-year terms, many mature between now and the end of 2025.

Interest-rate cuts alone won't bail out all these owners, as debt costs would need to fall very sharply to provide meaningful relief. In 2021, the secured overnight financing rate (SOFR), which was typically used to price most floating-rate loans, was around 0.05%, as compared to roughly 5.3% today. Moreover, nearly all properties are underperforming initial projections and loan underwriting due to insufficient rental growth, inflation in virtually all operating costs (especially wages and insurance), illiquidity, and excess supply. Obviously, the Clear Capital portfolio is not immune to these realities, as discussed below and in greater detail in our forthcoming individual asset-level reports.

In the second quarter, portfolios of foreclosed commercial property reached $2.05 billion, a 13% increase from the first quarter, representing the highest quarterly figure since 2015. Obviously, office is most troubled asset class, followed by apartment projects.





So, what is Clear Capital doing in this challenging and confounding economic environment?

On the one hand, the firm continues to evaluate acquisition opportunities, but identifying attractive deals remain elusive. Part of the challenge is a sharp decline in listings, as owners and operators wrestle with i) a challenging leasing environment, an elevated supply of competitive projects, soft rents, and the need to offer prospective tenants concessions (e.g., free rent); ii) higher delinquencies among existing tenants; iii) significantly higher operating expenses (e.g., wages, insurance); iv) a tight labor market for on-site staff (e.g., leasing, maintenance); and, v) persistently elevated mortgage rates. As current owners and operators work through these asset- and market-level challenges, including Clear Capital, we await a more stable economic backdrop (read: bull or more bullish market) before selling assets in our portfolio.

Meantime, when the 10-year Treasury yield fell to 3.60%+/-, we made immediate plans to refinance and recapitalize several projects, converting certain floating-rate debt into longer-term, fixed-rate financing. We submitted loan applications to some of our preferred lending partners, only to see those plans dashed (or dampened at least) by the subsequent spike in rates back above 4%. We still hope to refinance certain assets, though doing so may require a significant equity contribution or some sort of additional junior financing to gap the difference between the outstanding mortgage balances and that which can be obtained via refinancing. In some cases where refinancing is infeasible, we are negotiating with lenders to modify existing loan terms, thereby stabilizing assets and cash flows.

In short, we continue to work on multiple fronts, evaluating acquisition opportunities while closely managing every aspect of our existing portfolio.

Finally, three other interesting multifamily-related tidbits crossed my desk in the third quarter…

- **"America's smallest apartments are getting smaller"**: this headline from a recent WSJ wasn't surprising, as we have all heard stories of people living in what might be generously described as a janitor's closet in New York City or "micro-units" of 200 to 300 square feet in several large cities. My middle daughter pays something like $1,800 a month for something akin to a shoebox in Burbank (CA), within walking distance of her work.

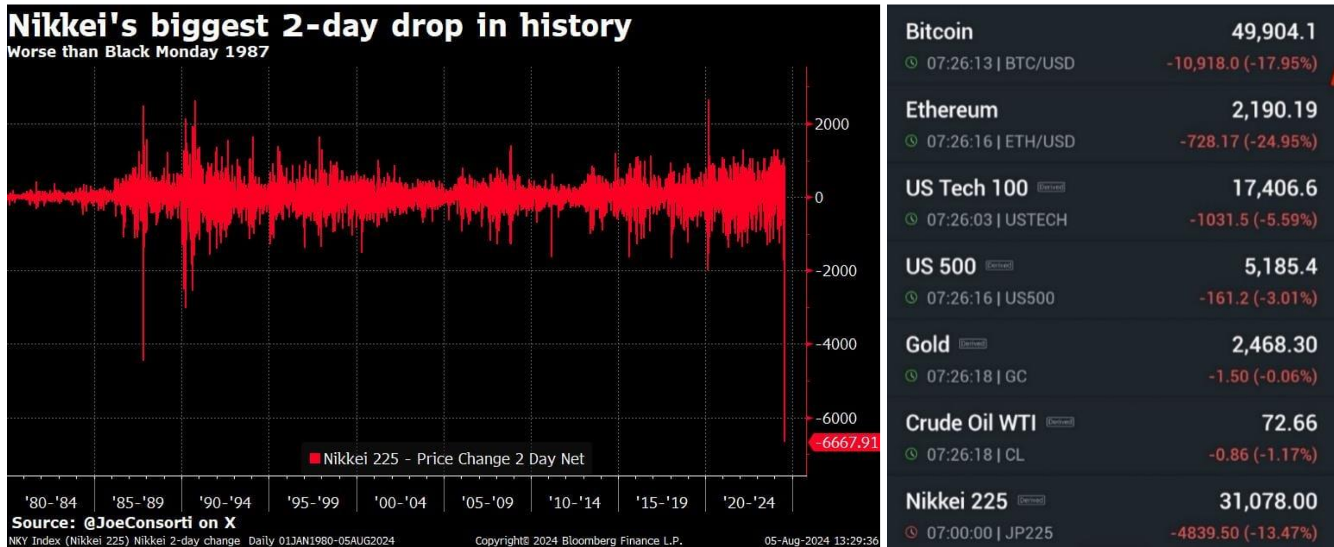
Smaller studios with minimal kitchen space and "open" floor plans are the rage these days, as developers strive to squeeze in more housing on any lot and as many units as possible within four walls. Let's face it, but the GenZers and Millennials increasingly use bars, kitchens, or Door Dash for their food and beverage needs, so who needs large kitchens and dining areas? Meanwhile, developers are creating more common areas and workstations where residents can work or relax outside of their micro-units.

- **Some of the largest investment firms in the country are buying billion-dollar multifamily portfolios**: We now have our third sizable apartment portfolio acquisition of the year with Equity Residential (EQR) acquiring 3,572 units from Blackstone for nearly $1 billion during the quarter. The units are mostly located in "expansion markets," as EQR have described them (e.g., Dallas/Fort Worth (1,237 units), Denver (978 units), Atlanta (1,357 units)). There are a couple of key takeaways from the deal. One, there is a market for Class A- or A product in larger markets. All of the acquired assets were built within the last 10 years. Two, those buyers waiting for bargains and 6.0%+ cap rates will likely be waiting for Godot.

- **U.S. Accuses Real-Estate Software Company of Illegally Coordinating Rent Prices:** In late August, the Justice Department and eight states sued RealPage, a company which provides a popular leasing software tool to multifamily landlords and property managers. The suit, filed in North Carolina federal court, alleges that the company illegally deploys a rent-setting algorithm that allows landlords to illegally coordinate price increases in violation of antitrust laws and stifles competition with its alleged 80% market share. It's an interesting case inasmuch as the suit names the software company, but no individual landlords, as the defendant. While not likely impacting Clear Capital and how we set rents, I will be following the case closely.

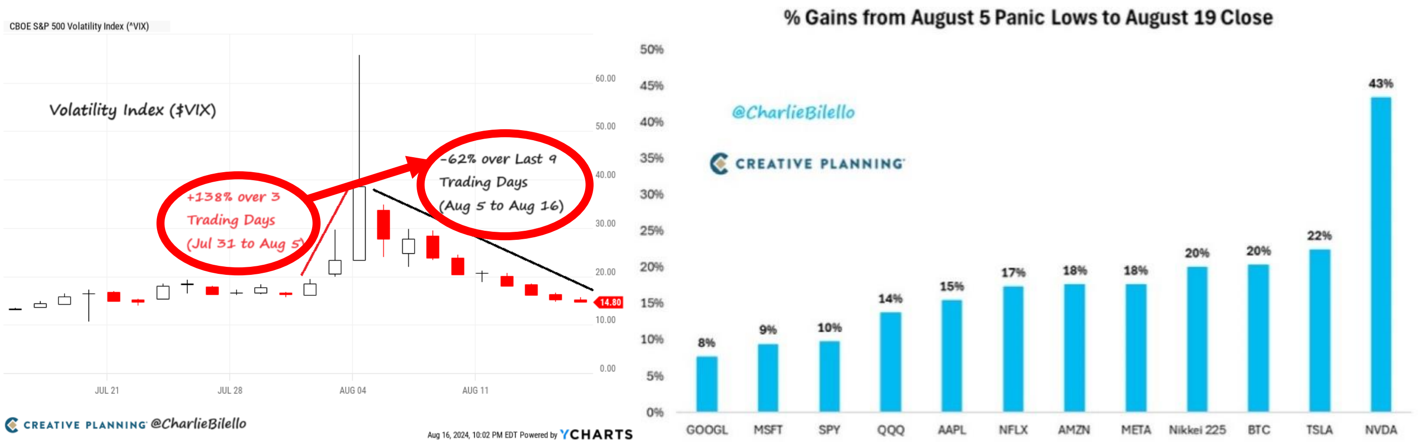
Given how the third quarter of 2024 began, it's shocking where we ended up…..

It's downright remarkable that the third quarter ended up where it did, given how it began. Just to show you how short memories and fickle investors are, I imagine that most of you don't even remember what happened just a couple of months ago, in early August, when the Dow and S&P 500 had their worst trading days of the year, down 3%, respectively. Japan's stock market experienced the largest two-day drop in history (nominal), an even larger drop than Black Monday's crash in 1987, with the Nikkei dropping 12% in a single day, tacking onto July 's double-digit losses. The VIX, a measure of market volatility, spiked to levels not seen since the Great Financial Crisis. Some of those horror movies don't fill my screen up with as much red as that brief market downturn.

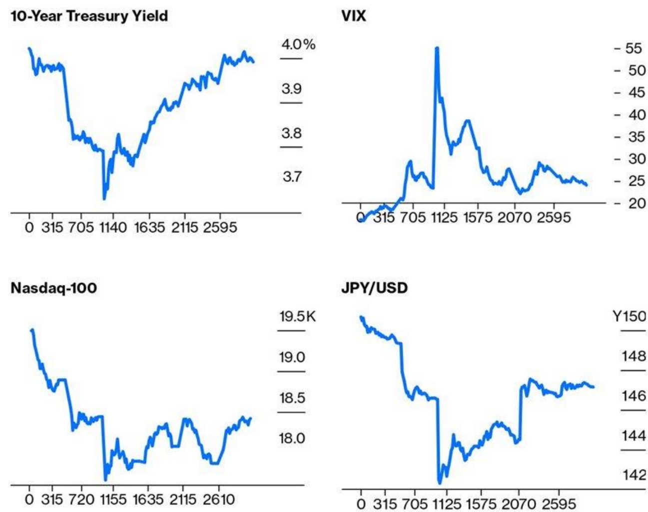


What caused global markets to suddenly swoon like that? Well, Japan raised interest rates for the first time in something like forever, compelling numerous hedge funds, and other investors to unwind their "Japan carry" positions. These investors had shorted the yen to buy U.S. dollars, dollar-denominated assets, and other high-yield foreign bonds (i.e., Mexico). When the Japanese Central Bank increased rates, the yen rallied sharply (from 160/USD to 143 or so) and this "no-brainer" trade, which had generated extraordinary returns in the past 24 months or more, turned sour, as investors were forced to cover their shorts…and all at the same time. We have seen how that story plays out. All exits can only handle so much traffic.

And then what happened? It all reversed in the blink of an eye, "like it never happened," as though ServPro had simply come along and cleaned up the mess. After the VIX increased 138% in three trading days (July 31st to August 5th), it declined 62% over the nine days thereafter. Stocks rebounded sharply, like it was all an abbreviated bad dream, reminding me of that adage that "there are decades where nothing happens and days when decades happen," …or something like that.



Did That Really Happen?
Several markets have completed the recovery from Monday morning's spasm



Source: Bloomberg

Bloomberg Opinion

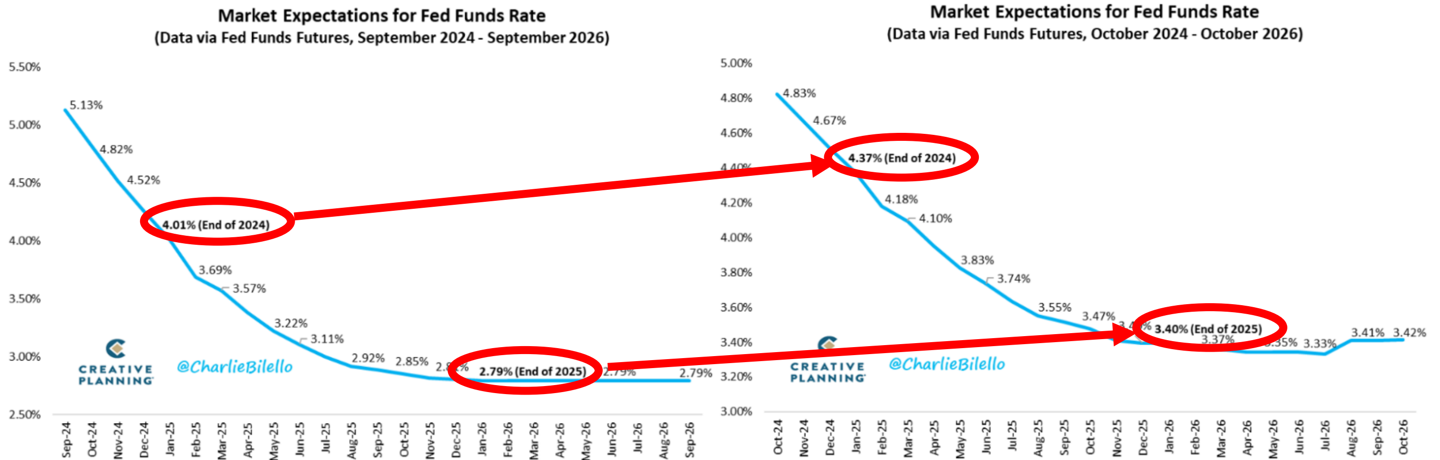
I suppose the key takeaway is that markets and investors are fickle, and investor psychology can shift lickety-split. I hope that the multifamily market – especially for Class B and C assets where Clear Capital plays – experiences a similar shift in investor and lender psychology next year. That would be most welcome.

So, what's the market expecting now with respect to interest rates?

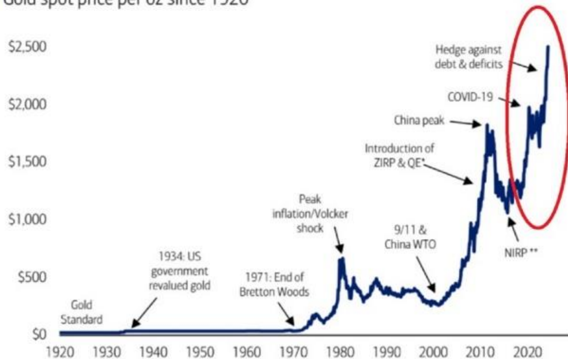
While recent data provides evidence that inflation is moderating, it is unclear just how much more headway can be made, given the underlying strength in the economy, recent jobs data, higher employee wages, strong equity markets, increased deficit spending and government borrowing, ongoing, if not expanding, global unrest, and recent natural disasters.

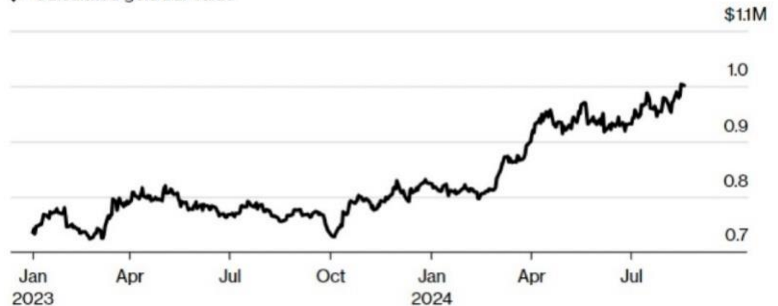
As a result, the Fed Funds future curve has been moving and shifting more than presidential polling data or the Dodger's starting rotation. At last glance, the market expects the Fed Funds rate to be 4.37% at the end of 2024 and 3.40% at the end of 2025 (versus 5.0% today). Yet just two weeks ago, the market predicted Fed Funds rates of 4.01% and 2.79%, at the end of 2024 and 2025 respectively, a significant shift in sentiment, again in the blink of that proverbial eye.

This sort of interest rate volatility creates significant challenges for real estate sponsors, investors, owners, operators, and lenders alike. How can anyone effectively price and underwrite potential acquisition targets in the face of such uncertainty and interest rate volatility? Refinance existing assets? Forecast cap rates?



If the price of gold is any indicator of expected inflation and general uncertainty, look out below. At $2,721 and change at last glace, gold is up over 13% in the last six months and 36% in the last year. Apparently central banks have been active buyers, especially China, perhaps in an effort to reduce their dependence on the U.S. dollar.



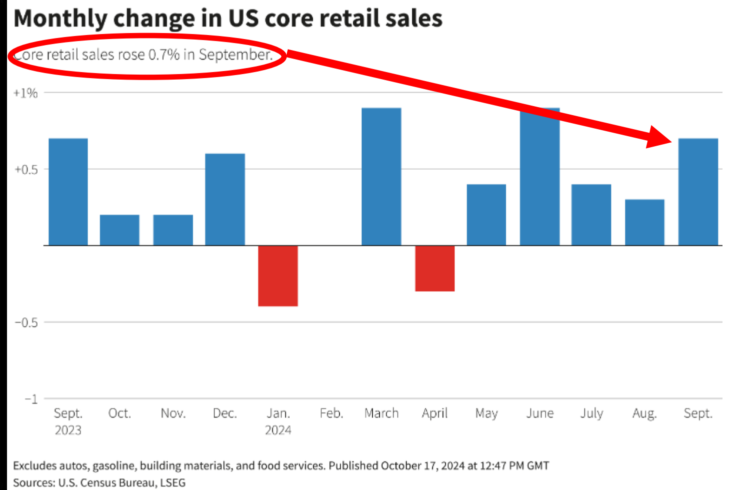


Part of the answer to all these economic questions and uncertainties depends on the consumer. So, for the gazillionith time, is the consumer tapped out.... or not?

It seems especially apropos to ask during the Halloween season "is the consumer dead or not?" Well, let's start with the obvious, that the U.S. is a consumer-based economy. To put it in profoundly wonkish academic terms, we like to buy stuff and how the consumer goes, the U.S. economy follows. After all, more than two-thirds of our GDP is based on the U.S. consumer. Thus, if the U.S. consumer continues to spend, any recession is unlikely. So, are they still spending or not?

Well, as unsatisfying as it might be, the answer remains, "it depends." According to retail sales figures released last week by the Census Bureau, shopper wallets are still accommodating.

Nominal retail sales rose 0.4% in September over August results, slightly exceeding expectations. However, excluding cars and gasoline, core retail sales rose 0.7 percent, far ahead of forecasts.

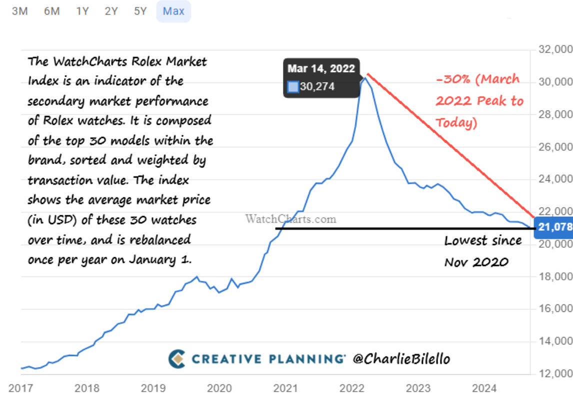


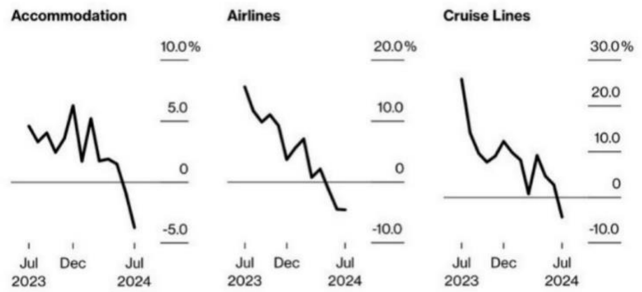
On the other hand, numerous companies have indicated that consumer demand is waning. Laurent Freixe, the chief executive of Nestlé, told analysts last week that consumer demand has been "subdued" in recent months across the food giant's operations. PepsiCo lowered its annual sales growth forecast, which the company attributed to "weaker consumer spending." Such comments echo those recently made by other companies, from Disney, AirBnb, and Nike. Is it just that the consumer is spending, but elsewhere?

It's hard to say. Deere & Co., the largest manufacturer of farm equipment, laid off about 15% of its hourly workforce in recent months, and a rival, Agco announced in June a 6% reduction in its salaried workforce. Whirlpool blamed soft housing market for reduced demand for appliances, while announcing a 7% decrease in sales. Flack Global Metals, Phoenix-based steel and aluminum distributor seeing "significantly less demand this year than last." So, a fairly wide swath of companies is signaling that consumers may finally be losing some spending mojo.

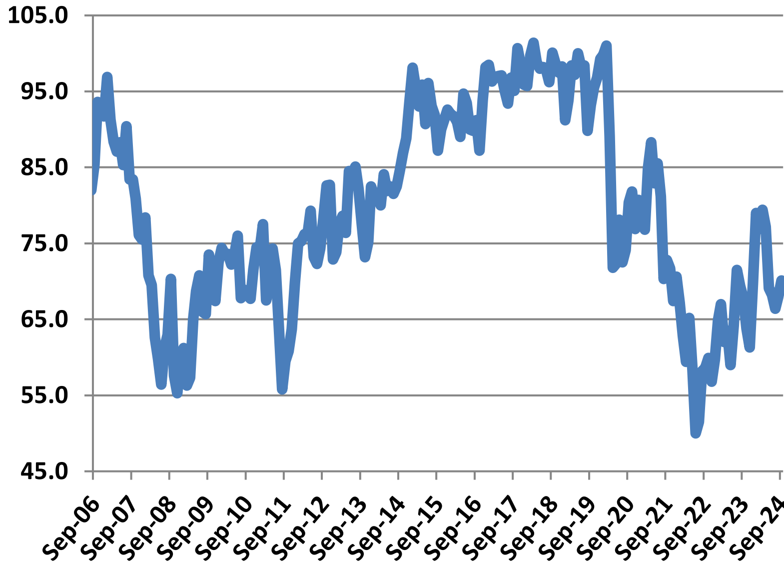
However, you may recall my view that if you really want to assess the strength of the consumer, pay attention to how much consumers are spending on travel or at places like spas, the salon, casinos, or maybe where you buy your macchiato double frap with soy or whatever, the sorts of locales where consumers expend discretionary funds (with apologies to those of you for whom massages and frappuccinos are necessities). So, what does that data tell us?

It, too, is mixed. On the one hand, the prices of fine wristwatches are down and down fairly sharply over the past couple of years, if the "WatchCharts Rolex Market Index" is any indicator. Shopping for hotel rooms, flights, and cruises? Visits to the top "travel brands" was down approximately 4 to 5% in July, while U.S. airline "traffic" for that month was up 4.5% from the prior year, according to the Bureau of Transportation, though down about 2.0% from June. Vegas gambling numbers? Nevada is witnessing modest decreases in gaming revenue. Nonrestricted gaming licensees' total "gaming win" (revenue earned by casinos) was 3.8% lower than the same period in the prior year. For the year, Nevada's total gaming revenue is down about 5.5%. This, depending on where you look, you can draw different conclusions.





So, how is the consumer "feeling"? Does that provide any sort of clue? Well, according to our friends at the University of Michigan, the Consumer Sentiment Index rose to 70.1 last month, up from 67.9 in August and 67.8 in September of 2023. While well-below pre-COVID levels, consumers are feeling far better than they were last year and the earlier part of this year, likely reflecting moderating inflation and reasonably strong labor markets. But not everyone feels similarly. I thought this graph was interesting, though not entirely surprising. Republicans are feeling far less rosy about how things are going.



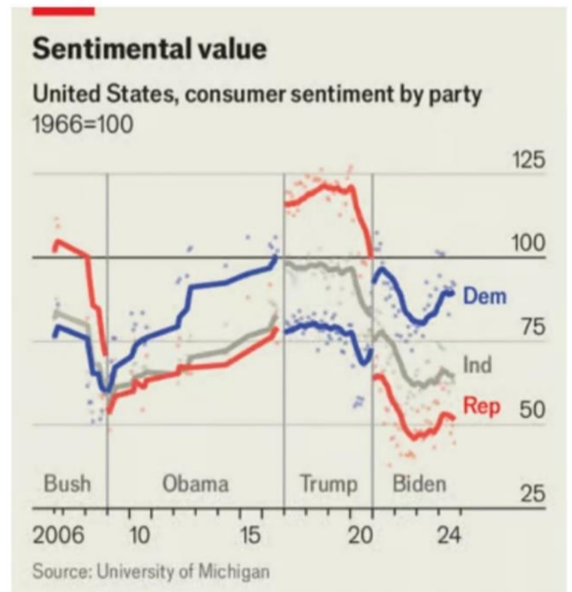
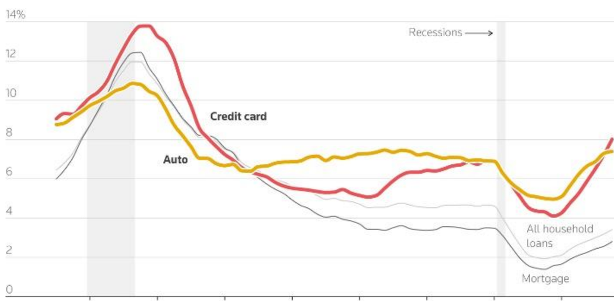
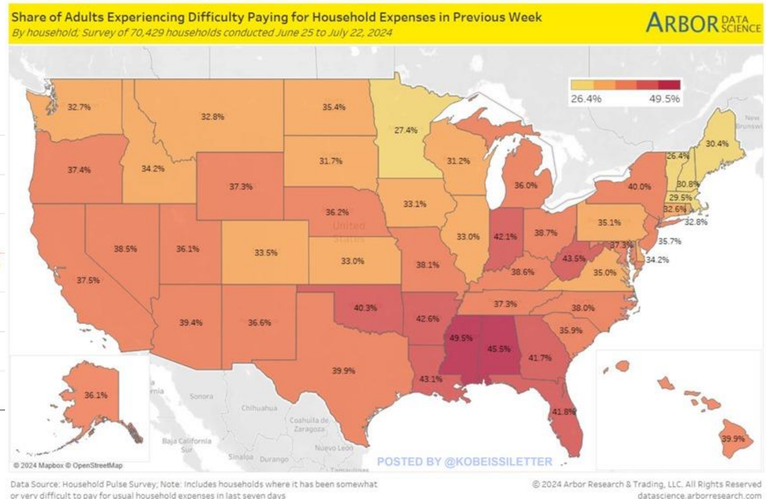


CHART: THE ECONOMIST

Finally, in one other piece of noteworthy data, consumers are falling behind on credit card and loan payments. Bread Financial, a credit card issuer serving lower income customers, recently indicated that charge off rates "will be elevated" for remainder of the year, while Synchrony Financial said that it is seeing higher charge-off rates than before the pandemic.





Perhaps it is merely the haves, who are "having," and the have-nots, who are still struggling with the significantly higher cost of housing, rent, and other staples, despite the rate of inflation moderating. They need more help before they decide to put on happier faces.

Unless you have been living under a rock, it's an election year, and Lord knows, politicians are active folks in election years!

Reading a headline that "rent control is on the ballot again" is like reading about a break-up of the "soulmates" who find each other on the Bachelor. Here in California, where rent-related measures are a recurring reality, all eyes are on Proposition 33, which would, "repeal current state law (the Costa-Hawkins Rental Housing Act of 199), expanding local governments' authority to enact rent control on residential property." Voters have rejected the same measure twice before, so let's hope that the third time is no charm.

To demonstrate how significant the measure would be, if it passes, San Francisco could automatically expand rent control to more than 100,000 units by a pre-approved ordinance. They could also add "vacancy control," a well-proven supply killer that limits what rents can be charged for new tenants when older tenants subject to below-market, controlled rents, vacate their units. I am sure that adding 100,000+ multifamily units to the rent-controlled rolls will truly solve the Bay Area's housing issues (#sarcasm). Give me a break.

Keep in mind that it's not just about how these sorts of measures impact rent, but about market supply and liquidity. Draconian rent control measures don't just reduce property values, they thwart new supply (e.g., common sense tells you that controlling rents will make new housing projects "more difficult to pencil out") and thin out the eligible buyer (and lender) pool. Just look at what happened to New York's apartment stock when the state mandated vacancy controls in 2019. Valuations plunged.

But wait! There's more. Proposition 34, a complex proposition, which on its face appears to be about drug pricing, would force healthcare providers to spend at least 98% of its revenues on "patient care" if it is passed. However, reading between the lines, it is clear that Proposition 34 has a different objective. AIDS Healthcare has been the principal sponsor of Proposition 33 and the two similar ballot measures that preceded it. Proposition 34, as I understand it, would prevent AIDS Healthcare and other healthcare providers from spending meaningful funds on endeavors askew of their missions. Thus, if Proposition 34 passes, it is unlikely we see a fourth ballot measure like Proposition 33 (assuming Proposition 33 goes down in flames once more,

which it should. You can probably guess how I am voting, but to be sure I don't leave it to chance, I would encourage my California friends to vote "no" on 33, "yes" on 34.

While I am as concerned as anyone about affordable housing, politicians and others need to understand that rent control and similar "economic sticks" are simply not effective. Stick to the "economic carrots."

No quarterly memo would be complete without a discussion of "other" topics worth mentioning not just because they are interesting, but because they will certainly impact commercial real estate markets going forward

- **Demographic changes, here and everywhere, continue to be extraordinarily impactful**: I am not exactly sure when I became so interested in demography, but I long ago learned how important it is whether evaluating the economy, real estate markets, and politics. Here are a few of the demographic headlines, which caught my eye this quarter.

  - **Worldwide Efforts to Reverse the Baby Shortage Aren't Working:** as I have stated ad nauseum, women in developed countries are having far fewer children than in the past. First and foremost, many more women have careers and are therefore delaying having children, if they have them at all. The cost of having, housing, clothing, feeding, and educating children has skyrocketed in recent decades, and let's be candid, but in the modern world, families don't need as many children to "work the family farm" or help the household in other ways. I sense that it has been both a financial and cultural shift. If you want to know how serious the issue is, look no further than Hungary and Norway, two European countries which devote more resources to families than almost any other nation.

    Despite their efforts, Hungary and Norway have fertility rates of 1.5 and 1.4 children per female, respectively, far below that needed to keep the population steady (about 2.1). If you were wondering, the U.S. fertility rate is 1.6. Thus, even if having children came with more all sorts of subsidies or financial benefits (e.g., low-interest loans for housing or other costs, a subsidized minivan, and/or extraordinary income tax incentives), would couples have more kids? The answer, it seems, is "no" or "not enough."

    After all, these are among the benefits — along with cheap childcare, extra vacation, and free fertility treatments — that have been doled out to parents in different parts of Europe, a region at the forefront of the worldwide baby shortage. Yet, Europe's overall population shrank during the pandemic and is on track to contract by about 40 million by 2050, according to United Nations statistics. Birthrates have been falling across the developed world since the 1960s. But the decline hit Europe harder and faster than demographers expected—a foreshadowing of the sudden drop in the U.S. fertility rate in recent years.

    So, what will be the impact of reduced fertility and childbirth rates? Reduced demand for housing overall (and much else)? Check. Greater demand for apartments versus single-family homes? Check. Deflation or reduced inflation? Check. One need only look at the impact of reduced birth rates on Japan, China, and the EU. And let's be clear. We need workers - skilled and unskilled - and to the extent that the domestic supply of labor is inadequate, we need to attract and yes, welcome, properly vetted immigrants and undocumented workers already living here, paying taxes, and contributing to our economy.

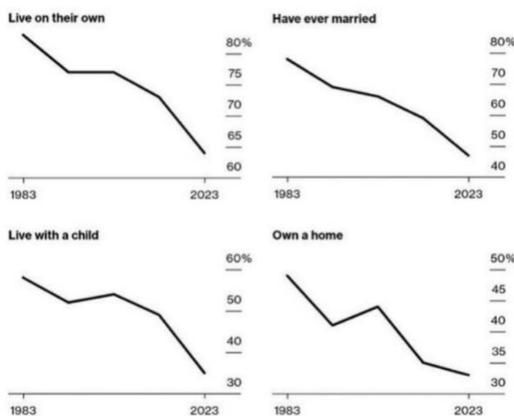
- **Why More Middle-class Americans are Defining Themselves as Working Class**: a growing number of Americans are struggling to afford their basic needs: housing, healthcare, food, and transportation. Inflation certainly shoulders some of the blame. B what does it even mean to be "middle class"? The traditional definition is income-based, that if one's annual household income is two-thirds the national median income, one would be considered a member of the middle-class tribe.

  However, consider that 18% of Americans have less than $100 (not a typo) in savings these days. And having an income of two-thirds the national median in many places means you cannot nearly afford a house in many places. Household income of $100K or more goes a lot further in Cheyenne, Wyoming than in Los Angeles, San Francisco, or New York City. Thus, I read that some demographers have coined a new acronym, ALICE – Asset-Limited, Income Constrained, Employed – to describe so many that would traditionally have been labeled "middle-class." Supposedly over 40% of U.S. households fall below ALICE's "Threshold of Financial Survival."

  We must do better with this demographic, as the consequences of failing to do so will be significant.

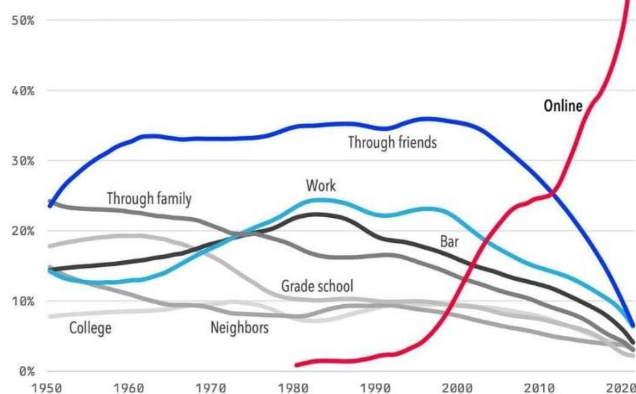
- **Data on Adult Milestones and How Couples Now Meet**: Finally, a couple of interesting graphs crossed my desk (screen?) this past quarter. The first summarizes a lot of what we already know. Young adults are marrying later, if at all, having fewer children, living with parents, and/or renting. Data from the second graph may inform the former. Previously, couples met through work, friends, or elsewhere. And now? Coffee Meets Bagel, Tinder, Match, eHarmony, Bumble, Hinge, and a dozen other apps act as modern-day Yentes (the gossipy matchmaker from Fidder on the Roof, for those of you unfortunately not in the know).

Adult Milestones
Share of US 30-year-olds who...



Source: John Burns Research and Consulting tabulations of US Census Bureau Current Population Survey Annual Social and Economic Supplement via IPUMS-USA

HOW COUPLES MEET IN THE US



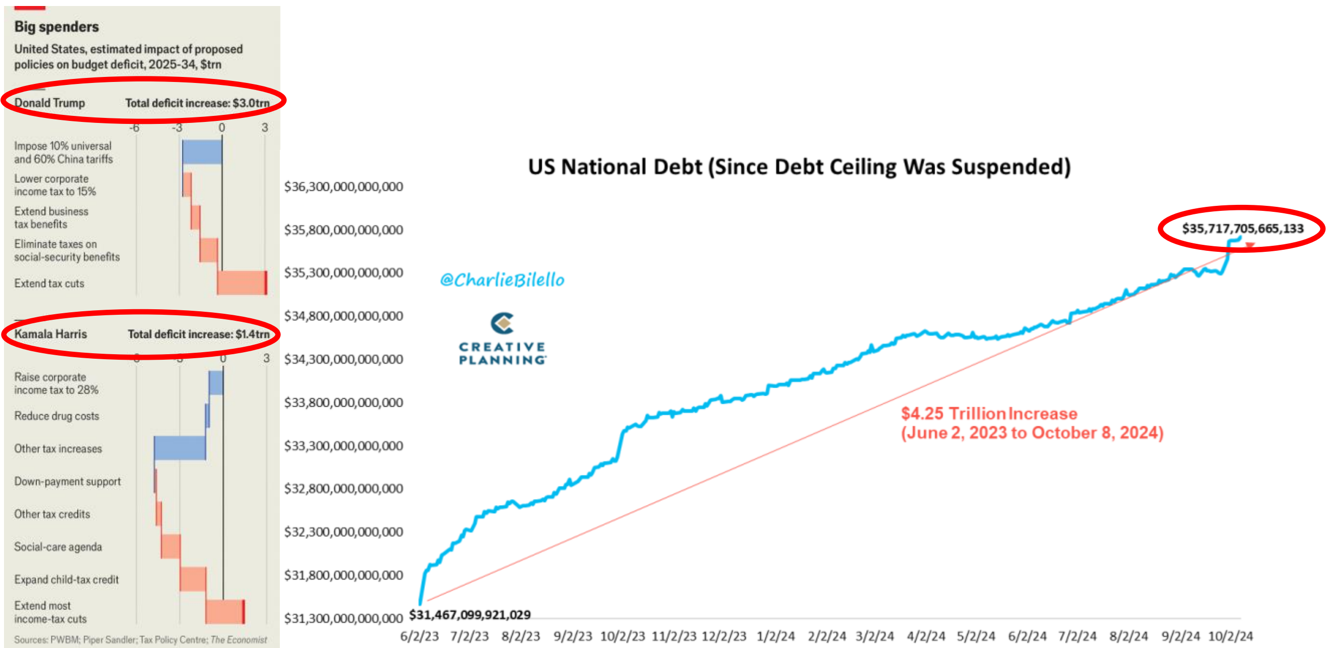
Source: "How Couples Meet and Stay Together": a longitudinal study of social life in the US by M. J. Rosenfeld, Reuben J. Thomas, and Sonia Hausen. Analysis of original survey data (n=6,519); "bars & restaurants" category cleaned to not double count couples who first met online.

The impact on everything from housing, to neighborhoods, to cities is and will be significant.

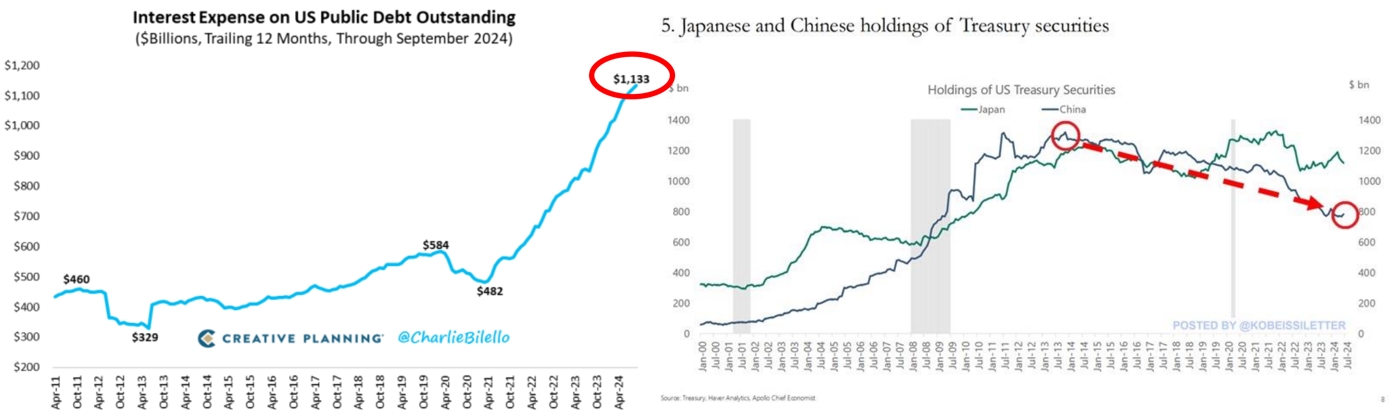
- **What are Trump or Harris going to do about our ever-growing debt levels and deficit spending**?: According to our national debt clock (https://www.usdebtclock.org/), our current national debt exceeds $35.7 trillion and is expanding $2 trillion a year (it increased over $4.2 trillion between last June and today), as both parties twiddle their

thumbs and point fingers at the other as being the "real spenders." Well, I will go out on a limb to suggest that whoever wins this election, our debt levels aren't going anywhere.

In fact, according to the Economist, Trump's economic policies (e.g., increase tariffs, tax cuts) would increase our annual deficit by $3 trillion and this doesn't seem to consider these loathsome mass deportation camps he wants to construct. And Harris? Her policies to expand entitlements and increase taxes would be about half as impactful ($1.4 trillion deficit). At some point, we need some grown-ups in Congress and the White House to take control of both our national balance sheet and its statement of cash flows, to put it in simple accounting terms.

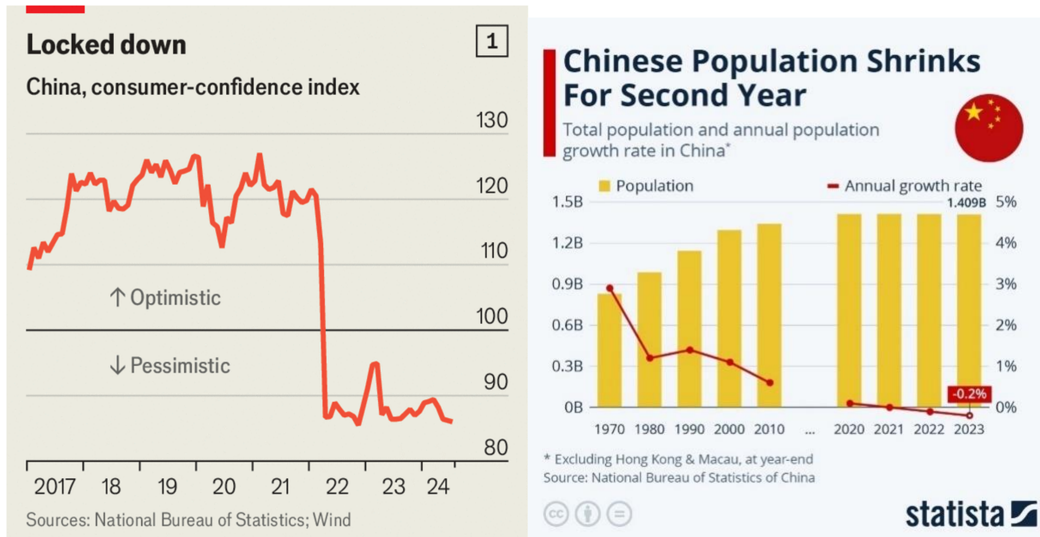


We are now spending over $1.1 trillion a year just on interest to service the public debt. And who, on God's green earth is going to buy all of our bonds and debt? Well, according to recent data, it's not likely to be two of our biggest supporters, China and Japan.

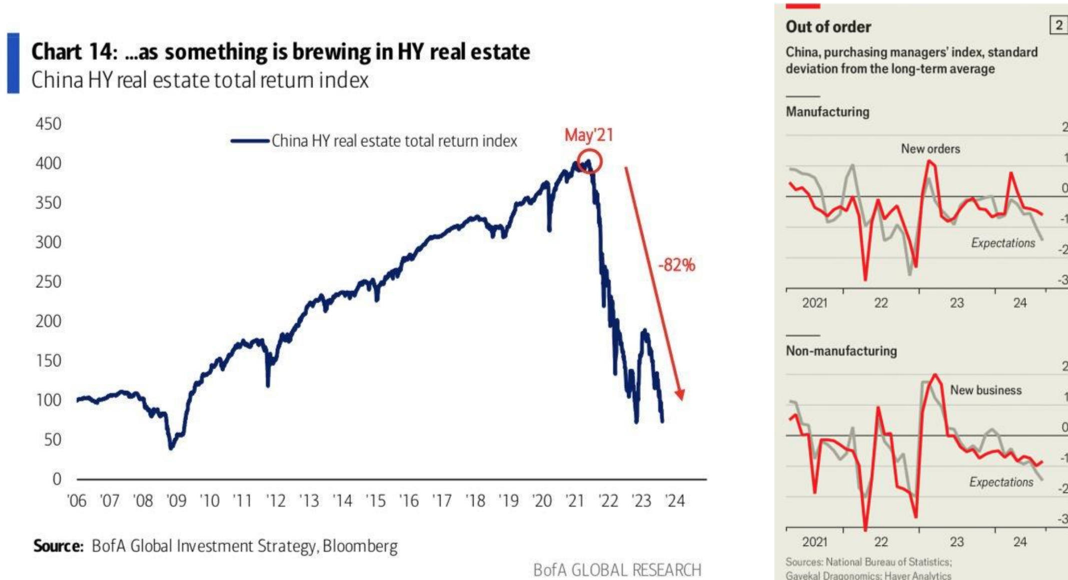


- **China, China, China**: The biggest story in the world right now may be China. The last time China was deflating this significantly, the country represented a whopping 3% of global GDP. Now at 20% of global GDP, China and its challenges on the global economy cannot be ignored or discounted. China's economic plight is deepening, heaping pressure

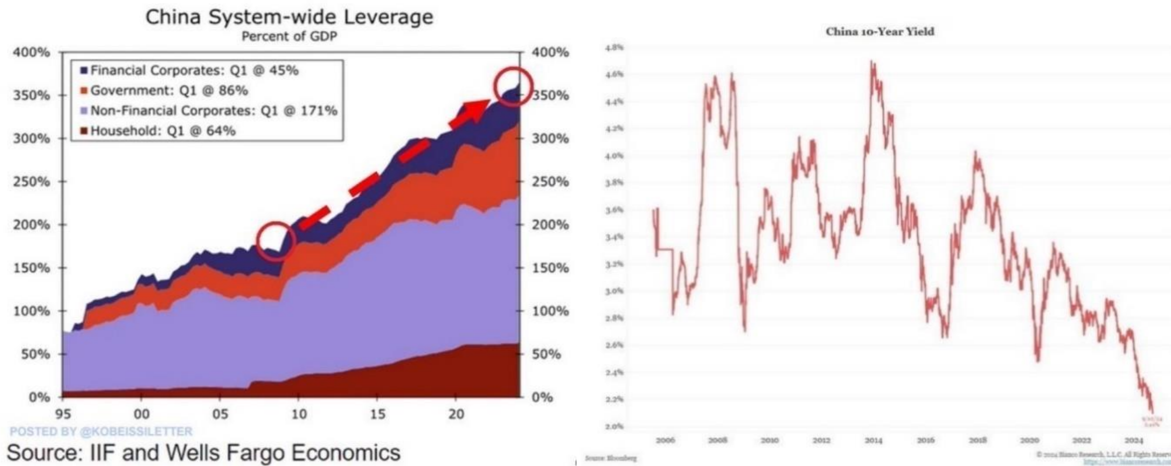
on Beijing to step up support for households or risk getting stuck in a low-growth rut beset by tumbling prices and squabbles over trade. Recently published figures show activity weakening across the board in August, with home prices recording their steepest annual fall in nine years. It really is kind of ugly, no matter where one looks, and it's simply remarkable that just a few short years ago, economists were predicting that China would eventually surpass the U.S. in economic output, that it was just a matter of time. Those predictions now seem significantly misplaced.



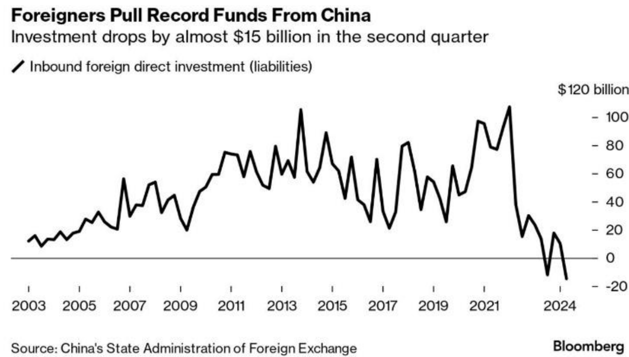
China's leaders seem wedded to their longer-term goal of fashioning China into a technological colossus impervious to Western meddling, even if that comes at the expense of short-term growth or rebalancing a lopsided economy that is too dependent on investment and industry but remains burdened by excessive debt and reliance on real estate as a means of wealth. Money is pouring into factories, and especially into priority industries such as electric vehicles, semiconductors, and renewable-energy gear. This would seem to be a reasonable strategy, but without population and skilled employees to support these endeavors, its ultimate chances for success remain in doubt.



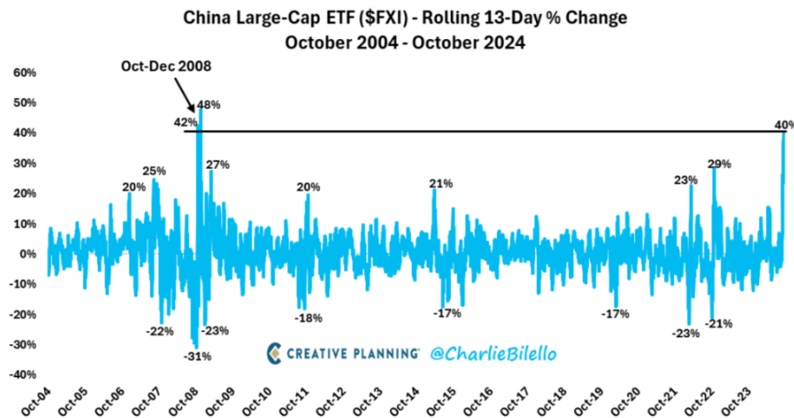
Yields on Chinese bonds have plunged, and systemwide leverage remains excessive, with total debt (corporate, government, and household) exceeding 350% of GDP, nearly three times the leverage in the U.S.



It cannot be any surprise that foreign direct investment in China is way down, as investors pull funds from the country, nearly $15 billion in the second quarter, a trend that appears to have carried over into the third (TBD).



In response, China has implemented a number of measures meant to prop up its struggling economy, improve bank liquidity, and restore investor confidence. Recent efforts include cuts in interest rates, reductions to banks' required reserve ratios, and an easing of restrictions on mortgage lending. And just last week, the People's Bank of China pulled the trigger on two funding programs – a share buyback ad swap facility - intended to inject as much as 800 billion yuan (roughly $113 billion), into its stock market. The response? China's equity market has increased nearly 40% since the start of the year and almost 30% since mid-September.



Regardless, without structural changes, I don't see these short-term salves as having longer-term impacts.

- **Glut of Life Science Space**: during the past few years, challenges in office market have been well documented. However, one previously "hot" area in the market, the demand for life science space has cooled considerably, resulting in a tripling of the industry vacancy rate since early 2022. If you want to know how serious the issue is, imagine that owners of at least 10 life-sciences locations in the Boston region are now offering these buildings for traditional office space. Yikes. Keep in mind that office rents are typically at least 30% less than that charged for typical office space. Owners of life-sciences buildings in Boston, San Diego and the Bay Area, traditional life-science locales, are feeling the heat. If there is any silver lining, it's that distress in life sciences doesn't pose as much peril to the broader economy as the carnage in the office market. The sector is much smaller, with less than 175 million square feet in the U.S. (versus 4.8 billion square feet of office space).

In conclusion, I cannot recall a market or economy with so many question marks and uncertainties, compounded by political theatre, global instability, excess equity market concentration, and fraught commercial real estate markets, with all eyes on the Fed….

In summary, just as I mentioned last quarter, the U.S. economy continues to confound, vexing the Fed and analysts alike. However, the equity markets don't really seem to care. The Fed cuts rates, the markets rally. Rates increase in the face of higher-than-expected inflation and job figures, and the market rallies. Weak housing data? Market rallies. Maybe the election will change things, and the next few weeks should be nothing short of interesting.

The sobering reality for commercial real estate investors is that future interest rate cuts are now far more uncertain, if and when they will come, and the magnitude of the cuts. Because of our tremendous debt, deficit spending, increasing debt service costs, and the risks that persist among regional banks, community lenders, and real estate sponsors (Clear Capital included), the Fed must feel tremendous pressure to cut and perhaps cut aggressively. Remember that commercial and residential real estate comprises the largest component of U.S. GDP, representing in excess of $8 trillion of annual output or nearly 30%. So, all eyes, ears, and computer screens are focused on the Fed.

So, when you are evaluating your Halloween options in the next week or so, I might seriously consider the Jerome Powell costume instead of something more traditional. Sure, Freddie, Chuckie, Jason, and Hannibal are powerful and scary. But until they can control monetary

policy and the direction of interest rates, they represent mere puppy dogs compared to our Banker in Chief. You won't win "best costume" at any party, but you will enjoy explaining to your fellow partygoers who you are and why you chose the costume that you did. And just imagine how much fun it will be explaining quantitative easing over a beer and a Hershey's Bar.

With that, thank you, as always, for your support, and for getting to the end of another lengthy quarterly market update. The entire Clear Capital team and I appreciate your support.

Best,

Eric Sussman
Managing Partner