The Economic Outlook for Investors and Business Decision Makers

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Topic One: Bullish Outlook Continues

America is recovering in spite of poor leadership in Washington, DC
The Elephant in the Room
Consumer Confidence Index

Source: The Conference Board
Personal Consumption Expenditures

Source: U.S. Department of Commerce: Bureau of Economic Analysis

2014 research.stlouisfed.org
Light Weight Vehicle Sales: Autos & Light Trucks

Source: U.S. Department of Commerce: Bureau of Economic Analysis
2014 research.stlouisfed.org
Consumers Paying Down Debt for First Time in 50 Years

Source: Board of Governors of the Federal Reserve System

2014 research.stlouisfed.org
Household Debt Service Payments as a Percent of Disposable Personal Income

Source: Board of Governors of the Federal Reserve System
2014 research.stlouisfed.org
Household Net Worth Recovering After Stock Market Rally

Source: Board of Governors of the Federal Reserve System
Households Have Lost Almost $8 Trillion in Real Estate Equity

Source: Board of Governors of the Federal Reserve System
2014 research.stlouisfed.org
Corporate Profits
(With Inventory Valuation Adjustment & Capital Consumption Adjustment)

Billions

Source: Department of Commerce
Small Business Outlook
“Planning To Hire People In The Next Three Months”

Net % of Respondents

Jan-98 to Jan-14
## Corporate Hiring Plans: Next 6 Months

<table>
<thead>
<tr>
<th></th>
<th>Q2-14</th>
<th>Q1-14</th>
<th>Q4-13</th>
<th>Q3-13</th>
</tr>
</thead>
<tbody>
<tr>
<td>More Jobs</td>
<td>43%</td>
<td>37%</td>
<td>34%</td>
<td>32%</td>
</tr>
<tr>
<td>Less Jobs</td>
<td>14%</td>
<td>19%</td>
<td>22%</td>
<td>24%</td>
</tr>
</tbody>
</table>

Source: Business Roundtable
# Job Openings in America

## Looking for Workers

<table>
<thead>
<tr>
<th>Category</th>
<th>Openings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Job Openings</td>
<td>4,635,000</td>
</tr>
<tr>
<td>Construction</td>
<td>130,000</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>292,000</td>
</tr>
<tr>
<td>Trade, Transportation, Utilities</td>
<td>784,000</td>
</tr>
<tr>
<td>Professional &amp; Business Services</td>
<td>919,000</td>
</tr>
<tr>
<td>Education &amp; Health Care</td>
<td>815,000</td>
</tr>
<tr>
<td>Leisure &amp; Hospitality</td>
<td>703,000</td>
</tr>
<tr>
<td>Government</td>
<td>423,000</td>
</tr>
</tbody>
</table>

Source: Bureau of Labor Statistics
BLS release on July 8, 2014
Civilian Unemployment Rate

2014 research.stlouisfed.org
Topic Two: Bifurcated Market

If you own stocks and houses, you are doing very well and spending money.

If you don’t, you aren’t doing very well and you are being impacted by rising prices for food and gasoline.
“Fundamental dynamics haven’t changed and household incomes are still flat. As we head into the political season and rhetoric heats up, it ill continue to challenge consumer confidence.”

-Bill Simon, US President of Walmart
Ailing Retailers

- Sears
- Penney’s
- Toys R Us
- Office Max
- Radio Shack
- Staples – may close 225 stores by the end of 2015
- Office Depot – plans to close 400 U.S. stores
- Radio Shack

Walmart sales have declined for 5 quarters in a row.

Nearly half of the 1,050 indoor and open air malls in the US have both Penney and Sears as anchor tenants.

Only six new malls have been built since 2010.

The number of “dead malls” with vacancy over 40 percent has nearly tripled since 2006 to 74 properties.
Topic Three: Housing
Apartments

Apartment rents have steadily increased for 17 quarters. They are now 11 percent higher than they were in late 2009.

A budding trend to convert downtown high-rise office buildings to apartments. Residential rents can now exceed the rent from office tenants.

Suburbs regain their appeal. Population in suburbs and exurbs is growing faster than the urban core of American cities.
Existing Home Sales
Houston

Source: Real Estate Center
Inventory of Unsold Homes
Houston

Jan. 1997 to Present

Source: Real Estate Center
Single-Family Building Permits
Houston

Source: Real Estate Center
Single-Family Building Permits
Houston, TX

19,503 Through June, 2014

Source: Real Estate Center
Houston Business-Cycle Index

Houston – Sugar Land – Baytown Business-Cycle Index

Index, October 1980 = 100*

*Monthly, seasonally adjusted.

Last data entry June 2014.

SOURCE: Federal Reserve Bank of Dallas.
### Houston-Sugar Land-Baytown Employment

<table>
<thead>
<tr>
<th>Industry</th>
<th>Jun-14</th>
<th>Jun-13</th>
<th>%Change</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Nonfarm</strong></td>
<td>2,886,500</td>
<td>2,799,000</td>
<td>3.13%</td>
</tr>
<tr>
<td><strong>Mining/Logging/Construct.</strong></td>
<td>310,400</td>
<td>298,100</td>
<td>4.13%</td>
</tr>
<tr>
<td><strong>Manufacturing</strong></td>
<td>259,700</td>
<td>252,800</td>
<td>2.73%</td>
</tr>
<tr>
<td><strong>Wholesale Trade</strong></td>
<td>158,000</td>
<td>150,300</td>
<td>5.12%</td>
</tr>
<tr>
<td><strong>Retail Trade</strong></td>
<td>286,600</td>
<td>283,300</td>
<td>1.16%</td>
</tr>
<tr>
<td><strong>Trans/Warehse/Util.</strong></td>
<td>136,800</td>
<td>130,700</td>
<td>4.67%</td>
</tr>
<tr>
<td><strong>Information</strong></td>
<td>33,200</td>
<td>32,700</td>
<td>1.53%</td>
</tr>
<tr>
<td><strong>Financial Activities</strong></td>
<td>145,500</td>
<td>143,200</td>
<td>1.61%</td>
</tr>
<tr>
<td><strong>Prof./Bus.Serv.</strong></td>
<td>442,200</td>
<td>429,700</td>
<td>2.91%</td>
</tr>
<tr>
<td><strong>Education/Health</strong></td>
<td>348,400</td>
<td>335,900</td>
<td>3.72%</td>
</tr>
<tr>
<td><strong>Leisure/Hospitality</strong></td>
<td>289,400</td>
<td>277,500</td>
<td>4.29%</td>
</tr>
<tr>
<td><strong>Government</strong></td>
<td>374,500</td>
<td>364,500</td>
<td>2.74%</td>
</tr>
<tr>
<td><strong>Federal</strong></td>
<td>27,200</td>
<td>27,500</td>
<td>-1.09%</td>
</tr>
<tr>
<td><strong>State</strong></td>
<td>70,700</td>
<td>70,200</td>
<td>0.71%</td>
</tr>
<tr>
<td><strong>Local</strong></td>
<td>276,600</td>
<td>266,800</td>
<td>3.67%</td>
</tr>
</tbody>
</table>
The Elephant in the Room

10-Year Treasury Rate
2.5 percent
Topic Four:
Too Much Money Chasing Deals
Too Much Money Chasing Deals

S&P 500 companies have parked $1.9 trillion of profits they have made outside the U.S.

• There is a total of $2.6 trillion in US money market funds.

• A recent report from Bain said PE firms have more than $1 trillion in unused cash at the end of 2013.

• Goldman Sachs has raised $2.4 billion for its second real estate debt fund. With leverage, it will be able to buy $4.2 billion in commercial real estate loans that mature in coming months.

• Carlyle Group raised $5.5 billion in new equity capital in 1Q2014, pushing total assets under management to $198 billion.
“In the US, there’s not much distress (in CRE) and I would say it’s just declining further and prices are high.”
– Hamilton James, president of Blackstone Group

“We are surprised at how ebullient credit markets have been in 2014. The world continues to be awash in liquidity, and investors are chasing yield seemingly regardless of credit quality and risk.”
- William Conway, Carlyle Group cofounder and co-CEO
Easing CMBS Loan Standards

In 2014, $42.7 billion in CMBS mature, but $100 billion in new CMBS are expected to be issued. This is up from $86 billion in 2013.

More than 25 percent of new CMBS had a LTV above 75 percent. This is up from just 5 percent in 2010.

Twenty-two percent of CMBS loans in 4Q2013 were made on properties with additional subordinated debt, up from just 10 percent in 4Q2013.
Big Dogs Selling?

In the past 18 months, Blackstone has picked up sales of properties, taking advantage of high prices investors are willing to pay for well-located CRE.

Last year, Blackstone sold $9 billion in office properties, up from $1.8 billion in 2012. Urban office building prices in 1Q14 were 11.3 percent above their 2007 peak levels.

Apollo Global Management is “selling everything that is not nailed down.” “Even I didn’t foresee the massive pace of sales.” -Leon Black CEO

Winthrop Realty Trust is liquidating the company. They were a firm buying/selling distressed deals. “I don’t see real relative investment value in the real estate space. Margins have compressed. – Michael Ashner, CEO

Carlyle Group sold $3.1 billion in assets in Q12014 and purchased $1.1 billion in new deals.
More Leverage on Takeovers

Wall Street banks are financing more private-equity takeovers with high levels of debt, despite warnings from regulators.

The Fed and the OCC issued guidance to avoid financing leveraged buyouts with debt more than six times Ebitda.

BUT, 40 percent of deals this year have exceeded that guideline. That’s the highest percentage since the peak of 52 percent in 2007.
Stocks

Retirement investors are putting more money into stocks than they have since the market got slammed in 2008.

Stocks accounted for 67 percent of employee’s new contributions into retirement portfolios in March. That’s the highest since March 2008 and compares with 56 percent in March 2009, when the market hit bottom.

In March, stocks made up 66 percent of assets in 401-k, up from 48% in February, 2009.
Stocks

Investors are piling into “penny stocks” at the fastest clip on record, in search of investments that promise outsized returns. Penny stocks are not listed on major exchanges. Volume at OTC Markets Group for these shares has increased 40 percent this year to a record $23.5 billion.

The penny stock market has been referred to as the “pink sheets”, because of the color of paper used to record the prices for unlisted stocks.
The Apex of Globalization?

Japan seeks to remove 60-year old constraints on Japan’s military, to play a greater security role in East Asia.

Nationalist candidates win big in European elections on anti-Euro sentiment.

China causing problems with Japan and Viet Nam and other neighbors.

Russia causing problems with all of its neighbors.

Iran causing problems with all of its neighbors.

Global perception that the U.S. doesn’t have the funds or the will to be the policeman of the world any longer.
China Housing Market

In the first quarter, housing sales were down 9.9 percent in China.

Housing demand is weakening because of widespread expectations that property developers, having already reduced prices sharply in some cities are going to cut further.

Property developers face a view among consumers that Chinese real estate prices have peaked. Potential buyers are hold off on purchases.

Chinese media quoted property tycoon remarks at a forum, where he compared the nation’s property market to the Titanic.

“I wouldn’t buy another home even with loosening restrictions. I’m a victim of oversupply.”
- Ye Zhengwei bought his first apartment in 2012 for $2250 per square meter. Now a developer is offering a comparable apartment for 25 percent less.
Margin Debt
Debit Balances at Broker/Dealers

Jan-98 Jan-99 Jan-00 Jan-01 Jan-02 Jan-03 Jan-04 Jan-05 Jan-06 Jan-07 Jan-08 Jan-09 Jan-10 Jan-11 Jan-12 Jan-13 Jan-14

Millions

Jul 2007 Dow 14,021
Jul 2008 Dow 10,827
Mar 2000 Dow 11,234
Mar 2001 Dow 9,106
Mar 2002 Dow 7,415
Jul 2009 Dow 8,087

Source: Standard and Poor's
Correlation: Margin Debt Growth and S&P 500 Growth