UCF College of Business Administration

Dr. P. Phillips Institute
for Research and Education in Real Estate

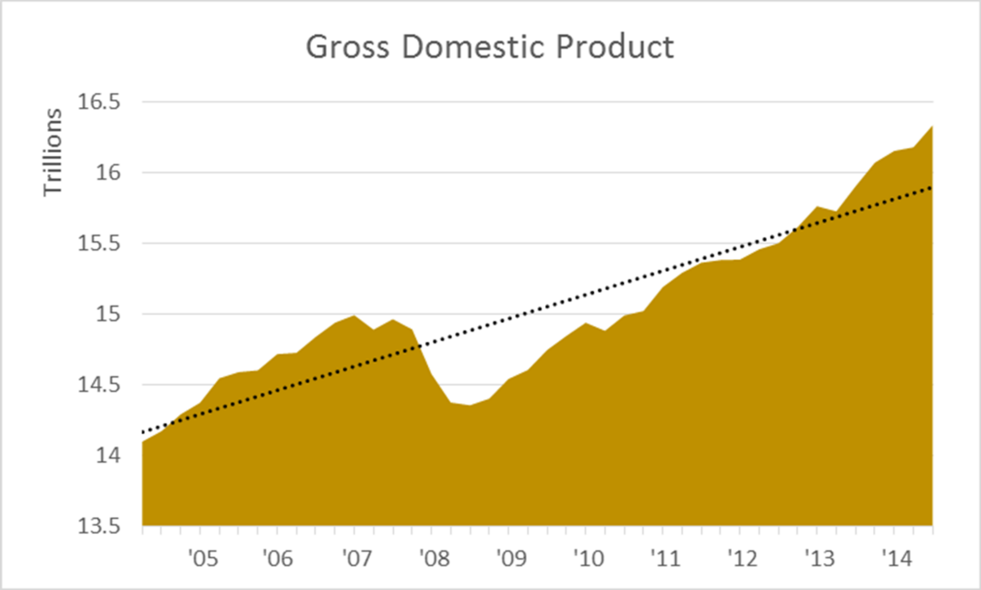
2015 Economic Outlook: What's Next?

Real Estate Notes, No. 7, October 2015.

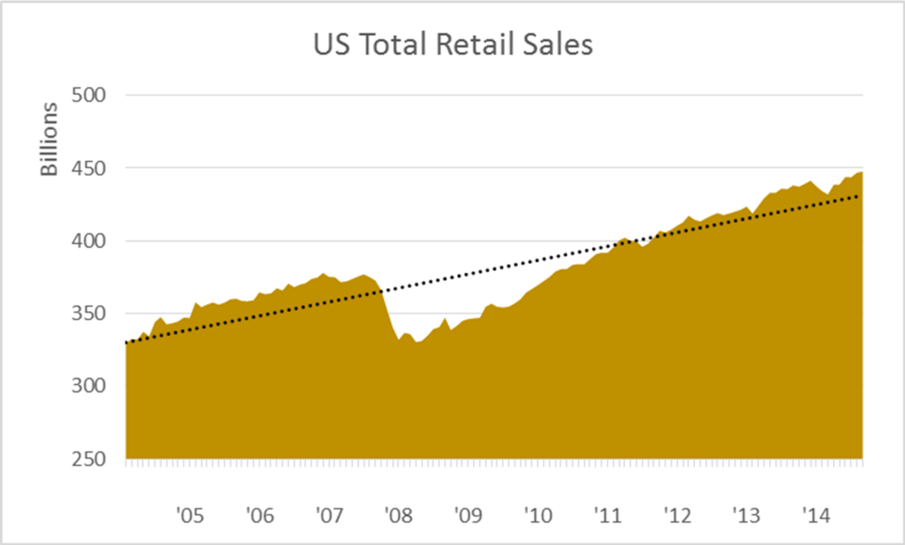
Joshua A. Harris, Ph. D., CAIA,
Director of the Dr. P. Phillips Institute for Research and Education in Real Estate
University of Central Florida

From time to time it is necessary to present a view on what is occurring in the national economy and what it means to local and national real estate markets. What follows is a series of charts, data, and commentary from a recent presentation given by Dr. Harris to real estate industry practitioners. The views and statements presented herein are that of Dr. Harris alone and not necessary endorsed by the Dr. P. Phillips Institute for Research and Education in Real Estate or the University of Central Florida.

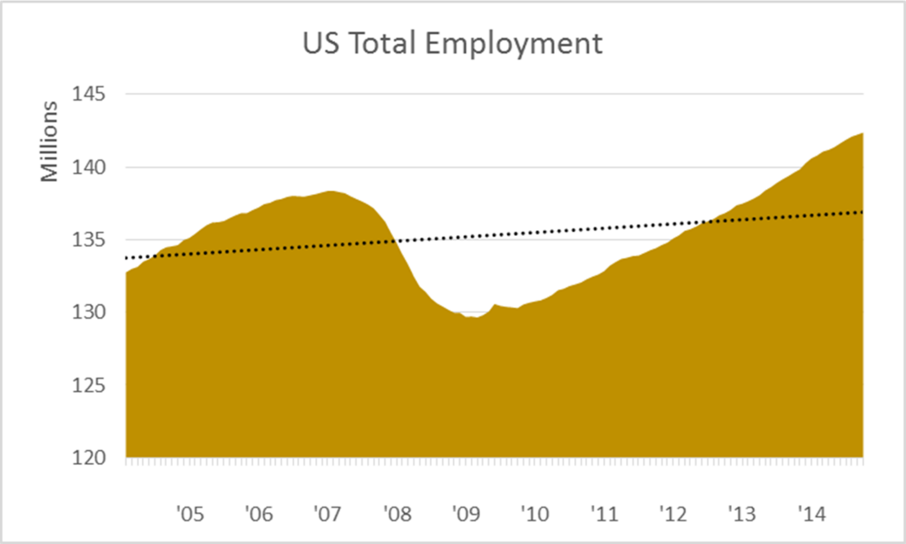
Overall, the U.S. economy is experiencing slow, steady growth and has been doing so since 2010 following the recession. In fact, real Gross Domestic Product is well above pre-recession peaks and has been setting new records almost every quarter. Still, 2015 has experienced a slow down due to global pressures and falling energy prices. 2016 and 2017 are likely to be slower growing as well.



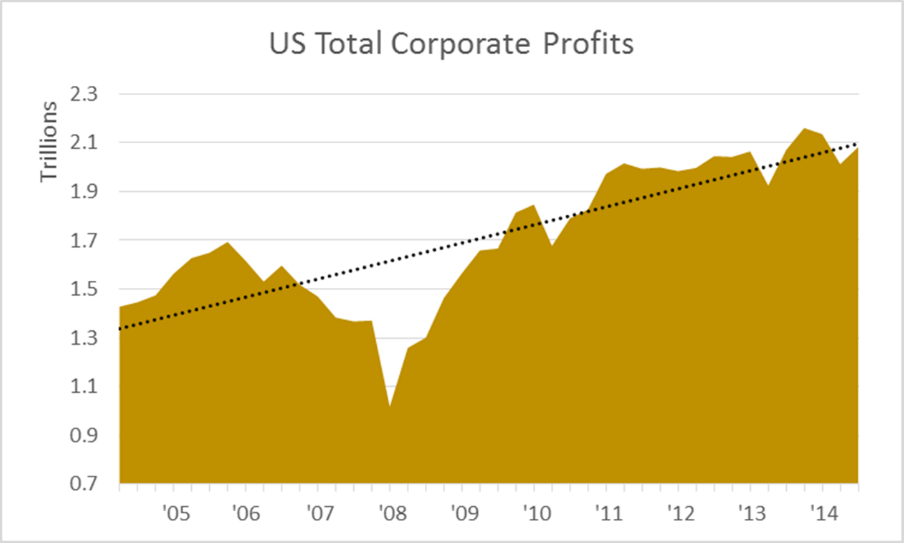
Perhaps a more interesting and telling data point on the U.S. economy is total retail sales. As the chart below indicates, we are spending more than we ever have and are setting new records almost every month. This is impressive given the fact that cash-out refinance mortgage loans are almost impossible and credit is much tighter for the consumer. This can be attributed to many factors including economic growth, job growth, low interest rates, and raw demographics (i.e. the millennials are becoming shoppers).



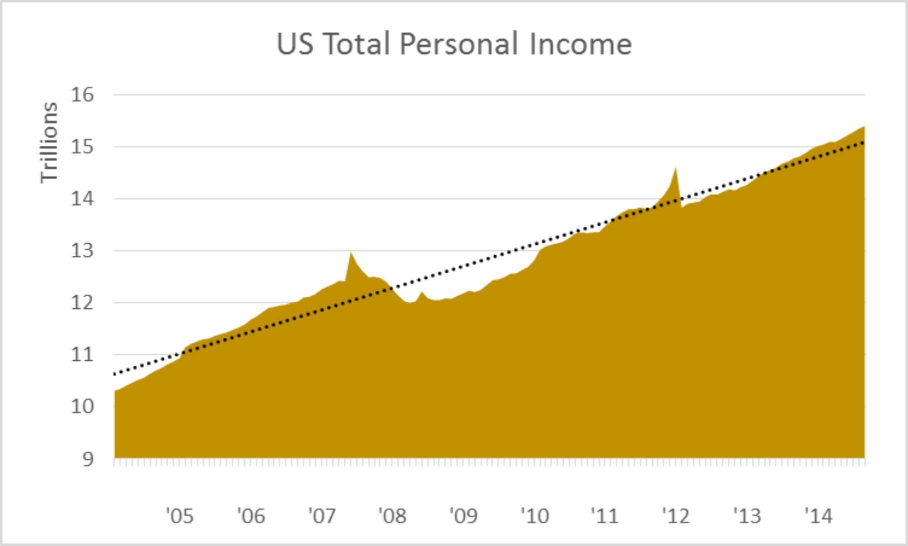
Job growth has returned but it took a very long time, no doubt influenced by the new regulatory regimes of Dodd-Frank and the Affordable Care act (aka Obamacare). If fact, in took until May of 2014 to recover back to where we were pre-recession.



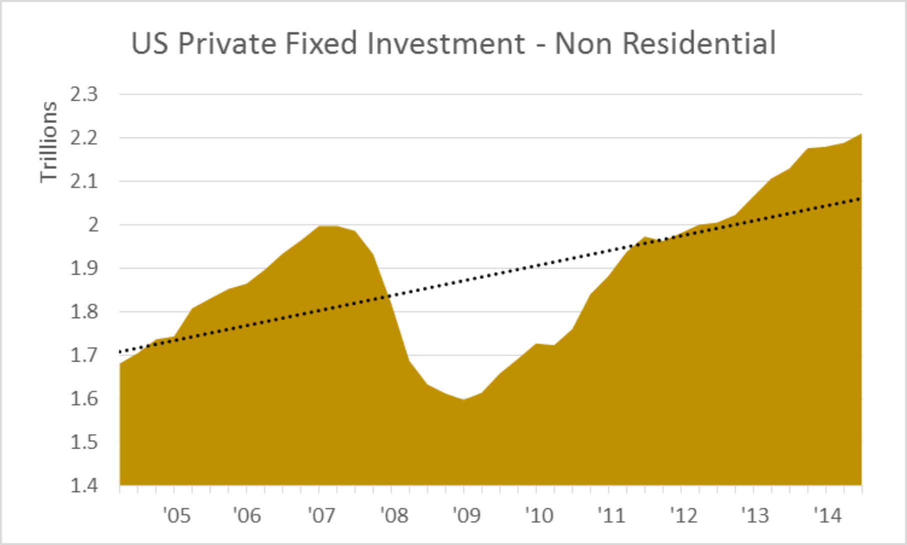
Not surprisingly, total corporate profits are at near record highs as well. U.S. corporations recovered very quickly due to the use of layoffs and other cost cutting measures and by refinancing corporate debt at all time low interest rates. Economic growth has helped in recent years, but as the chart shows the first to effects were the largest.



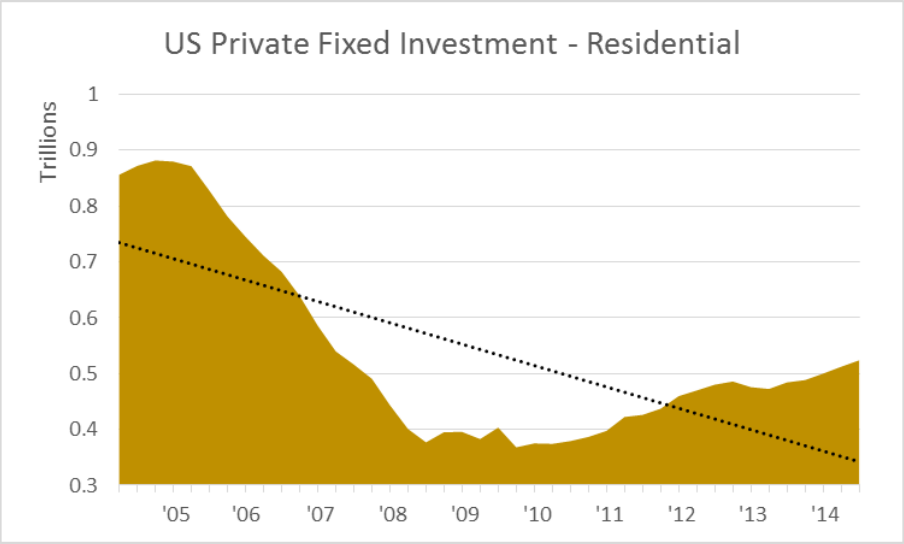
It's not just companies, people are also making more than ever in aggregate. The chart below shows how total personal income in the U.S is at all time highs. See that peak at the end of 2012? That is the direct impact of the "fiscal cliff" and it's impending tax hikes; people sold assets to realize gains in 2012 rather than gamble on Congress.



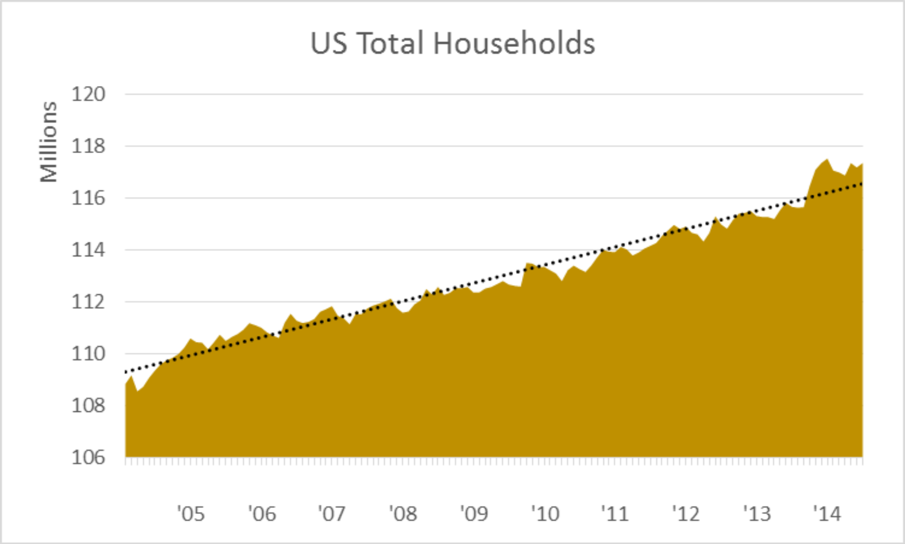
The combination of slow to moderate economic growth, employment recovery, and low interest rates have led to major expansions in non-residential private fixed investment. This did not really occur in earnest until 2013 and is perhaps one of the brightest areas pointing to future growth.



The same cannot be said for residential private fixed investment. It is still way below pre-recession peaks, which may in fact be good as we were severely over investing in this category before the housing bubble popped.



This level of low new housing development may actually lead to shortages in some markets as population growth and new household formation has not slowed down given the recession. Thus, from a supply and demand of physical space view, we are not in any immediate danger of another bubble or crash.



The conclusion that the space markets are healthy is many if not most markets for many if not all property types is fairly easy to make. Economic demand has rebounded and new supply has been low across the board since the recession. Commercial and investment real estate prices have rebounded considerably with the low interest rates dragging down capitalization rates. Thus, the real risk to the real estate markets is a significant rise in interest rates raising cap rates and lowering values. Such a trend could occur despite growth in rents and occupancies.

About the Author:

Dr. Joshua Harris serves as the Director of the Dr. P. Phillips Institute for Research and Education in Real Estate at the University of Central Florida where he is responsible for directing research initiatives, industry outreach, and program development. Dr. Harris also teaches real estate and finance courses at the undergraduate and graduate levels. Dr. Harris holds a Ph. D. in Finance from the University of Central Florida with a research emphasis in institutional real estate and capital markets. Dr. Harris holds the Chartered Alternative Investment Analyst designation, been named an Honorary Kentucky Colonel and a NAIOP Research Foundation Distinguished Fellow. Dr. Harris is routinely called on as an expert witness and for media interviews in the field of real estate, finance, and economics.

Real Estate Notes is a publication of the Dr. P. Phillips Institute of Research and Education in Real Estate at the University of Central Florida. The purpose of this publication is to present timely summaries of current relevant research in the fields of real estate, finance, and urban land economics to the professional and academic communities to aid decision making and understanding the marketplace. The conclusions and opinions expressed in *Real Estate Notes* are not necessarily those of the Dr. P. Phillips Institute of Research and Education in Real Estate, the Dr. P. Phillips School of Real Estate, or the University of Central Florida.