



NESS & ASSOCIATES



“Dynamic Geopolitics,
Critical Elections, and a
Shifting Capital Market:
Shaping Commercial Real
Estate's Future in the
United States.”

Background of Professor Ness

- Finished my undergraduate degree in Real Estate Finance in 2006
- Started cutting my teeth in commercial real estate valuation
- Realized I did not want to be appraiser, went back to graduate school in 2010
- Spent ten years in commercial real estate capital advisory, investment banking and restructuring in New York City
- Moved to Louisville, KY in August 2020
- Started teaching at U of L in Spring 2021



Background of Professor Ness

- I have a bachelor's degree in Real Estate Finance and master's degree in International Real Estate Finance
- I am a CFA Charterholder ("CFA"), CAIA Charterholder ("CAIA"), Member of the Appraisal Institute ("MAI") and a Counselor of Real Estate ("CRE")
- Only real estate professional in the world with all four designations
- I have valued BILLIONS of real estate assets
- I have capitalized BILLIONS of real estate transactions



Today's Agenda

- I. Setting the Context
- II. Global Conflicts
- III. Global Elections
- IV. The U.S. Presidential Election
- V. Still Addicted to Cheap Capital
- VI. U.S. Commercial Real Estate – What Is Not Being Discussed
- VII. Survive to 2025?
- VIII. Closing Thoughts



I. Setting the Context



Setting the Context

Quote from Marc Rowan



According to Apollo's CEO, Marc Rowan



“What did we expect would happen when we printed **\$8.1 trillion for the country?** Well, exactly what should have happened, happened. Assets almost across the board were elevated in price to multiples and levels we had never seen before. Risk was up, everything went up, interest rates went down. Now that we have begun tightening, **we are doing nothing other than resetting to normal levels...**”



Setting the Context

Quote from Marc Rowan



According to Apollo's CEO, Marc Rowan



We act in the market backdrop is somehow that **low interest rates and excess liquidity are the norm**. They are not. Certainly not over my nearly 40-year career and not over any sort of long-term investment cycle. We have an **entire generation** of investors, investment analysts who have really grown up just seeing the market go in one direction. And we now all know it goes both ways.”



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Setting the Context

Quote from Jenna Smialek

According to Jenna Smialek of The New York Times

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“The pandemic, and now geopolitical upheaval, have taken the economy and shaken it up like a snow globe. The flakes will eventually fall – **there will be a new equilibrium** – but things may be arranged differently when everything settles.”



Setting the Context

“The Lords of Easy Money”



According to “The Lords of Easy Money”



“During FOMC’s January 2013 meeting, Powell abandoned his tone of moderation. Instead, he delivered a warning about the dangers and distortions of quantitative easing that was blunt, and even horrifying in its way...

Many fixed-income securities are now trading well above fundamental value, and the **eventual correction could be large and dynamic**”



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Setting the Context

We are in Unprecedented Times

According to Federal Reserve Chairman Jerome H. Powell

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“We need to watch carefully as the economy continues to get through the pandemic and try to understand the ways that the economy has changed and what the implications are for our policy...”

We’re not simply going back to the economy that we had before the pandemic.”



Setting the Context

We are in Unprecedented Times



According to Mr. Powell's 2024 Jackson Hole Speech



“The time has come for policy to adjust. The direction of travel is clear, and the timing and pace of rate cuts will depend on **incoming data, the evolving outlook, and the balance of risks.**”

Since the Federal Reserve cut rates by 50 Bps (9/18/24), the **10-Year Treasury has increased 60 Bps, from 3.70% to 4.30% as of 11/1/24**



II. Global Conflicts



Global Conflict Middle East



- Hamas, an Iranian-backed militia, attacked Israel on October 7, 2023
- The conflict has escalated into a broader regional crisis, drawing in Hezbollah, an Iranian-backed group in Lebanon, and involving direct confrontations with Iran
- If the conflict continues global oil markets could be disrupted, as Iran is a major producer
- “With escalations in the Middle East, markets are shifting into partial risk-off mode, as **oil, gold, and the USD trade higher**. Any further escalation could amplify this flight to safety, impacting market stability.”

- Julius Baer, Wealth Management Insights



Global Conflict Russia-Ukraine War



- In 2014 Russia annexed Crimea, which escalated into full scale war in 2022
- This war has had significant impacts on global energy markets as well as food and agricultural commodities
- Russia is one of the world's largest producers of oil and natural gas, particularly for Europe
- “The Russia-Ukraine conflict has caused significant disruptions in global food supply, particularly affecting wheat, corn, and fertilizer exports, which Ukraine and Russia together contribute to in large quantities. These disruptions are leading to price volatility and affecting food security worldwide.”

- World Bank



Global Conflicts Genocide in Sudan



- The RSF and allied militias have systematically targeted Massalit and other non-Arab communities in Darfur with widespread killings, torture, and sexual violence
- Human rights organizations, including the UN, have called for sanctions and international intervention to protect civilians and prevent further atrocities
- The violence has displaced nearly half a million people, with many fleeing to Chad
- Despite severe atrocities occurring in Sudan, including what some describe as signs of genocide, **the crisis has largely been neglected on the world stage**



Global Conflicts Commodity & Trade



- Conflicts in Ukraine and the Middle East disrupt essential trade routes, limiting the flow of oil, gas, grains, and metals
- Attacks on shipping routes and potential threats to oil supply from the Gulf region push up oil prices and disrupt global energy flows
- The Russia-Ukraine War has caused a spike in natural gas prices, tripling fertilizer costs and squeezing global agricultural output. This has contributed to food price inflation worldwide, especially in regions highly dependent on imports
- In terms of U.S. real estate, global conflict has a direct correlation to replacement costs and benchmarks as it relates to going-in and exit capitalization rates.



III. Global Elections



Global Elections European Parliament



- Recent EU climate and energy regulations demand significant upgrades in building efficiency, pushing U.S. investors in European real estate to retrofit properties to comply with new standards
- The rise of Euroskeptic parties in the European Parliament has introduced volatility and uncertainty, creating risks for capital markets and potentially slowing U.S. investment flows
- Potential shifts in EU trade and investment policies post-election may impose new barriers for U.S. firms, complicating their ability to navigate European markets
- Proposed foreign investment restrictions in sensitive sectors, including commercial real estate, could limit U.S. firms' participation in large-scale European projects



Global Elections Taiwan



- Taiwan's election results will play a critical role in shaping its relationship with China, as pro-independence and pro-status quo candidates present drastically different approaches
- Taiwan's central role in global semiconductor manufacturing means any political instability could disrupt this crucial supply chain, impacting industries from technology to automotive worldwide
- Political stability in Taiwan is essential for maintaining secure supply chains, as the island is a key provider of high-tech components. Any escalation in cross-strait tensions could risk delays and shortages in Taiwanese exports
- Taiwan's political direction will influence security across the Asia-Pacific region, as its relations with both China and the U.S. affect regional defense dynamics and economic stability

Global Elections India



- With over 900 million eligible voters, India's General Election represents a massive democratic process, setting the tone for its regional influence and global economic partnerships
- Post-election urbanization policies could drive real estate opportunities, attracting domestic and foreign investment to India's rapidly growing cities
- Potential changes in labor laws may affect India's manufacturing and agricultural sectors, influencing global commodity supply and prices
- As a major oil and gas consumer, India's energy policies post-election will impact global energy markets, potentially driving shifts in demand and pricing



Global Elections Impact on Geopolitics, Commodities & Trade



- The outcomes of these elections will shape regional and global geopolitics, influencing alliances and trade agreements. For example, the EU election could redefine relations with both the U.S. and Asia, while Taiwan's election impacts U.S.-China tensions. India's election will also affect regional stability and partnerships within Asia.
- The EU election could shift trade dynamics with Asia, particularly around key sectors like technology and manufacturing, potentially altering global trade routes. Stronger EU-Asia partnerships may lead to trade diversions affecting U.S. exports to these regions.
- These elections, especially in India and Taiwan, are critical for commodities due to their influence on supply chains and consumption. India's policies could affect global energy markets as it's a major oil consumer, while Taiwan's stability is essential for semiconductor supply, impacting industries worldwide.

Global Elections A New Equilibrium?



- BRICS should be a “Primary channel for strengthening solidarity and cooperation among Global South nations and a **vanguard for advancing global governance reform.**”
- “We should **champion true multilateralism and adhere to the vision of global governance** characterized by extensive consultation, joint contribution, and shared benefits.”
- “We should advance the process of expanding BRICS membership and establishing a partner country mechanism and enhance the representation and voice of developing nations in global governance.”
 - Chinese President Xi Jinping at the 16th BRICS Summit
- “The pandemic, and now geopolitical upheaval, have taken the economy and shaken it up like a snow globe. The flakes will eventually fall - **there will be a new equilibrium** – but things may be arranged differently when everything settles.”

IV. The U.S. Presidential Election



U.S. Presidential Election

How Polarized Are We?



“I’m tired of hearing this is the biggest election in your lifetime...the reality is over time, it doesn’t matter.”

- Larry Fink, Chairman & CEO of Blackrock

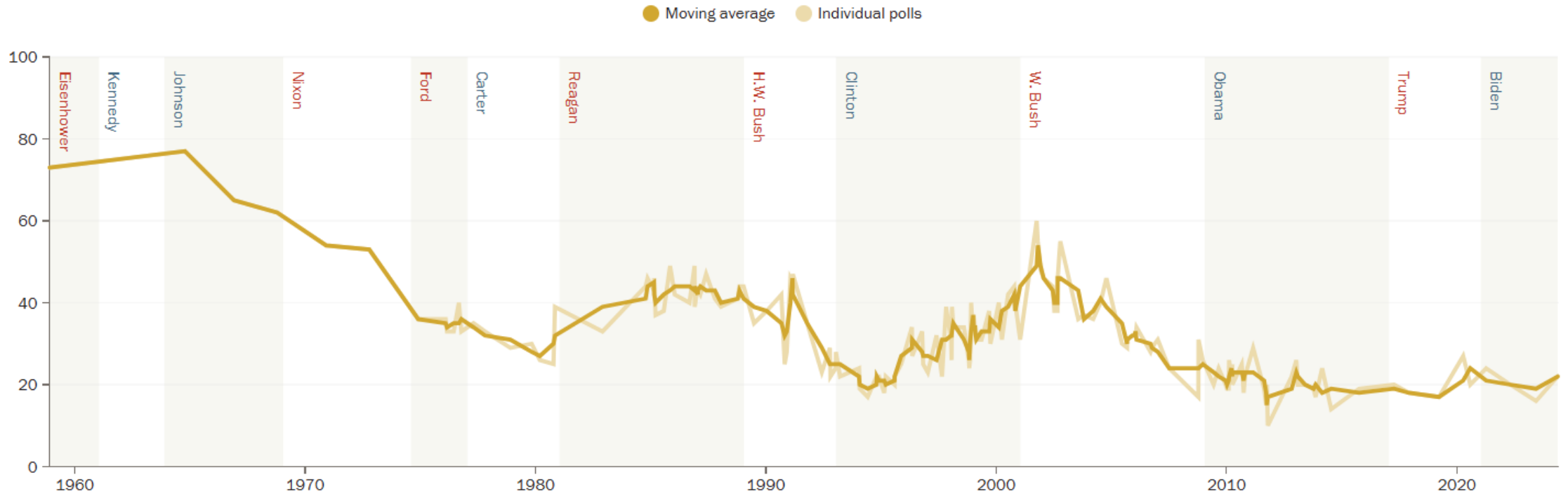
“Vote like your life depends on it because it does.”

- Kamala Harris, 2024 U.S. Presidential Candidate



Public trust in government near historic lows

% who say they trust the government to do what is right just about always/most of the time



Sources: Pew Research Center, National Election Studies, Gallup, ABC/Washington Post, CBS/New York Times, and CNN surveys.

PEW RESEARCH CENTER



U.S. Presidential Election Economic Policy & Inflation



“War breeds Inflation while geopolitical stability brings price stability. Republicans will end the global chaos and restore Peace through Strength, reducing geopolitical risks and lowering commodity prices.”

- Make America Great Again

"The Vice President will build on progress made to strengthen and diversify our supply chains for food production, processing, and distribution."

- A New Way Forward for the Middle Class



U.S. Presidential Election Climate Change & Energy Policy



“Harris-Walz will work to lower household energy costs and create millions of new jobs while...holding polluters accountable to secure clean air and clean water for all.”

- A New Way Forward for the Middle Class

“Republicans will unleash Energy Production from all sources, including nuclear, to immediately slash Inflation and power American homes, cars, and factories with reliable, abundant, and affordable Energy.”

- Make America Great Again



U.S. Presidential Election Immigration



“Republicans will secure the Border, deport Illegal Aliens, and reverse the Democrats’ Open Borders Policies that have driven up the cost of Housing, Education, and Healthcare for American families.”

- Make America Great Again

“The Vice President has endorsed comprehensive immigration reform, seeking pathways to citizenship...for people living in the country illegally who arrived as children.”

- Where Trump and Harris Stand on Immigration and Border Security



U.S. Presidential Election Foreign Policy & National Security



“America cannot sit on the sidelines and cede leadership to nations like China, jeopardizing our national security.”

- A New Way Forward for the Middle Class

“Republicans will bring critical Supply Chains back to the U.S., ensuring National Security and Economic Stability, while also creating Jobs and raising Wages for American Workers.”

- Make America Great Again



U.S. Presidential Election Federal Deficit



“We face massive headwinds with debt set to reach an all-time record share of the economy by 2027; and we don't even have a plan to address our fiscal challenges.”

- Maya MacGuineas, President of the Committee for a Responsible Federal Budget

"However, neither major candidate running in the 2024 presidential election has put forward a plan to address this rising debt burden."

- Committee for a Responsible Federal Budget



U.S. Presidential Election Federal Deficit



“The approaching US president election is exacerbating that concern as neither candidate has prioritized deficit reduction.”

- Ed Yardeni, President of Yardeni Research

Treasury Yields Resume Climb After Auctions Stir Supply Anxiety

- Two- and five-year notes drew higher-than-expected yields
- Analysts say auction size increases in 2025 are inevitable



The US Treasury Department in Washington, DC. Photographer: Al Drago/Bloomberg



U.S. Presidential Election Federal Deficit



“I continue to be concerned about the level of spending and deficits in the United States. Unless we have policy change and get our spending and our debt under control, ultimately that’s going to have a bigger impact on long-term rates than I think people are anticipating today.

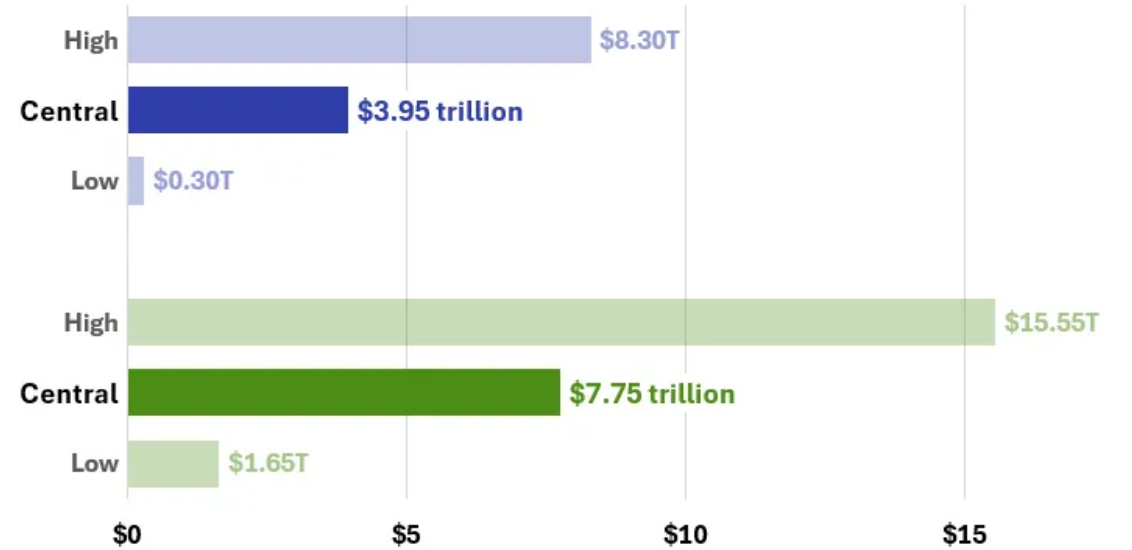
- David Solomon, CEO of Goldman Sachs Group



U.S. Presidential Election Federal Deficit

“Vice President Harris’s plan would increase the debt by \$3.95 Trillion through 2035, while President Trump’s plan would increase the debt by \$7.75 Trillion.”

- Committee for a Responsible Federal Budget



V. Still Addicted to Cheap Capital



Cheap Capital America's Addiction



- “We have an economy and a market that have become **addicted to ultra-low interest rates.**
- As a result, every time there is a report that rates may come down, like what we saw with the latest CPI report, the markets overreact like any addict.
- Long-term addictions don’t go away overnight.
- In order to ultimately break this addiction, it’s going to take some pain and time as the markets gradually adjust to a **higher for longer interest rate environment.**”

- Scott Rechler, CEO of RXR Realty



Cheap Capital Extend-and-Pretend



- Banks, particularly those with weaker capital positions, have extended the maturity of impaired CRE loans to avoid realizing losses, a practice known as “extend-and-pretend.”
- The study finds that this behavior has led to a decrease in new CRE loan originations, with an estimated drop of 4.8–5.3% since early 2022. This “credit misallocation” has hindered the adjustment of the CRE market to new post-pandemic realities, like shifts in office demand due to remote work.
- The extensions have resulted in a “maturity wall,” where a significant volume of CRE loans is set to mature soon. As of late 2023, this volume is estimated to represent 27% of banks’ capital, posing risks if many loans default simultaneously.

- “Extend-and-Pretend” in the U.S. CRE Market
Federal Reserve Bank of New York



Cheap Capital Extend-and-Pretend

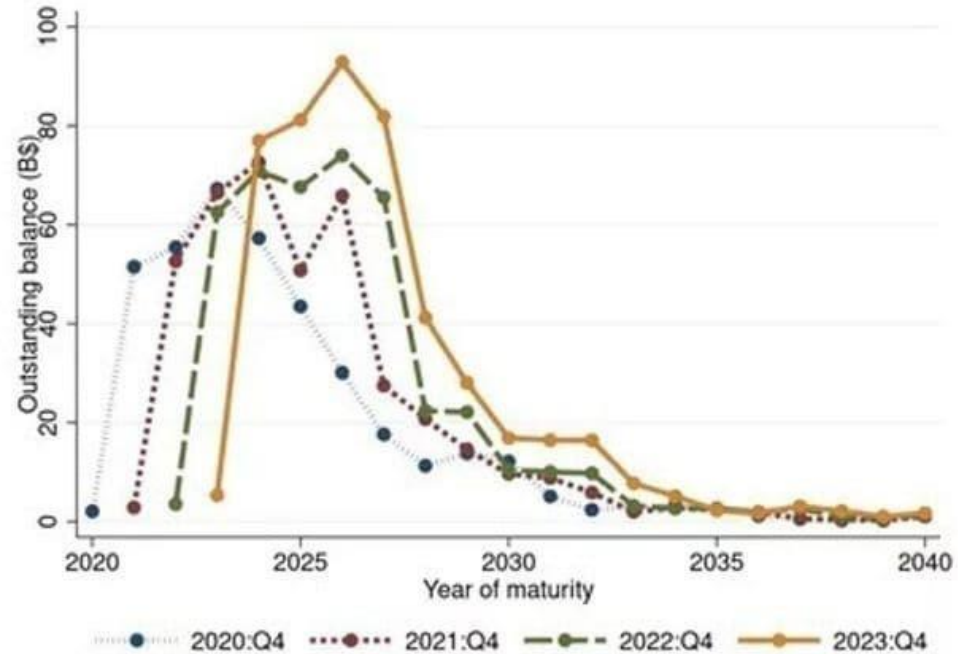


Figure 6: A rapidly expanding maturity wall. This figure shows the maturity wall faced by our sample banks as of 2020:Q4, 2021:Q4, 2022:Q4, and 2023:Q4. Each line shows, as of one of these four dates, the dollar value of CRE mortgages expiring in each year in the future (x-axis). Mortgages maturing after 2040 are cut off for exposition purposes. Source: FR Y-14Q Schedule H.2.



Cheap Capital The Equity Gap



- Ness & Associates Equity Gap sizing focused on the primary and secondary markets of Louisville, Indianapolis, Cincinnati, Columbus, Charlotte, Nashville, and Atlanta.
- The Maturity Wall is based on a three-year maturity wall (2024, 2025, and 2026) which totals \$18.9 Billion (senior debt only).
- Per our calculations, at a normalized 10-Year US Treasury of 3.945% the Equity Gap sized to \$2.86 Billion.
- If we extrapolated this on a nationwide basis to reflect a Maturity Wall of \$1.436 Trillion, the **National Equity Gap would be approximately \$194.25 Billion!**



Cheap Capital Price Stability?



- Inflation is reportedly under control and is down year-over-year, but prices are still significantly higher than pre-pandemic.
- In September, the Consumer Price Index for All Urban Consumers rose 0.2%, seasonally adjusted (“SA”), and rose 2.4% over the last 12 months, not seasonally adjusted (“NSA”). The index for all items less food and energy increased 0.3% in September (SA); up 3.3% over the year.
- Although a decrease from the post-pandemic peak of 9.1%, **the Consumer Price Index is 21.8% higher than it was in January 2020.**
- Furthermore, shelter costs have risen 23.8% since January 2020, which continues to exacerbate the affordability crisis in the real estate market.



Cheap Capital Back to the 2.0% Target



- There is a record amount of capital invested in Money Market Funds – approximately \$6.55 Trillion as of Q2 2024.
- A well-documented concept, **Risk-Taking Channel of Monetary Policy**, argues that when rates are low...investors move out of low-yielding safe assets, demand for riskier assets increases.
- As savers shift to riskier investments (e.g., equities and real estate), rising asset prices can create a **Wealth Effect**, where investors feel richer and thus increase their consumption.
- If the 2.0% target were raised, there is concern that it could lead to an un-anchoring of inflation expectations, **causing inflation to rise more unpredictably and potentially harm economic stability.**



VI. U.S. Commercial Real Estate – What Is Not Being Discussed



Commercial Real Estate What Is Not Being Discussed

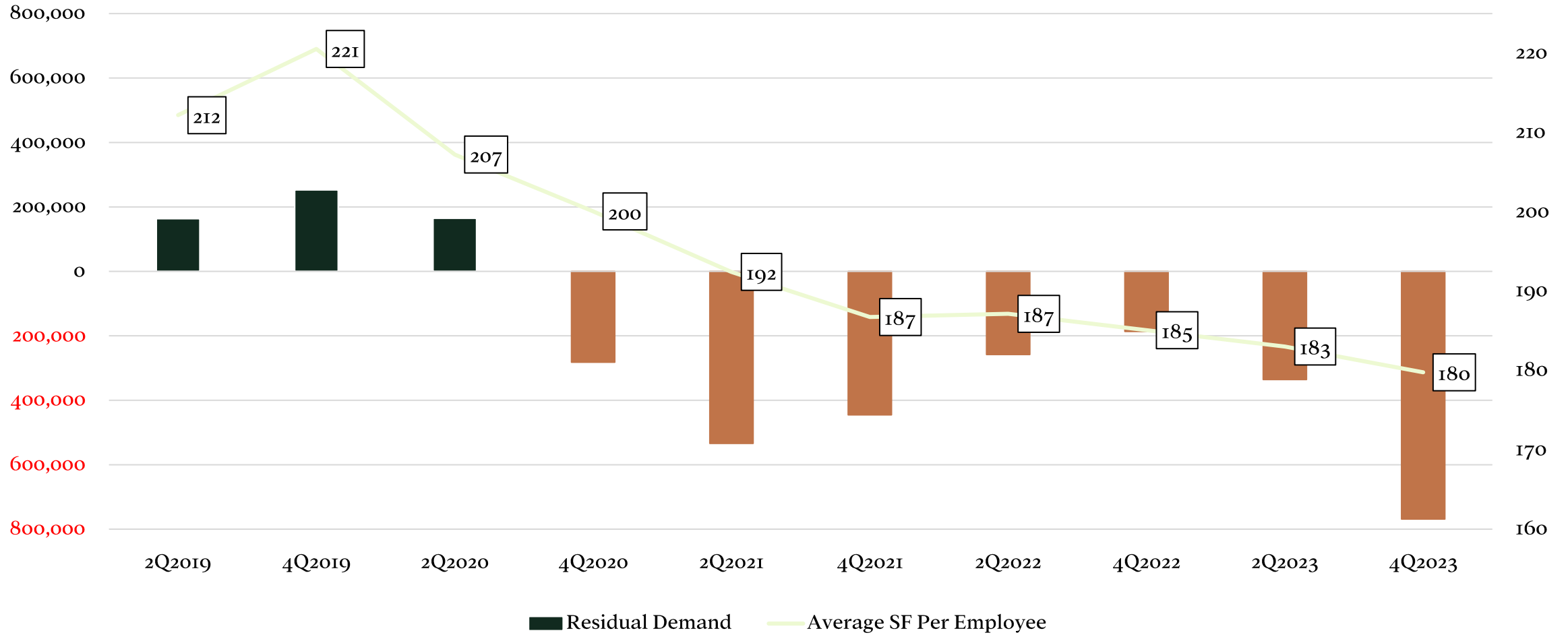
Fundamental Equilibrium in Office Space



- This secular shift in the **Fundamental Demand** office space is attributable a permanent reduction in **Office Space Per Worker** attributable to Work-From-Home, Hybrid Work, and Hoteling.
- According to a Use Case analysis conducted by Ness & Associates' sister company, **CREnetics**, the Office Space Per Worker for the South Brooklyn submarket has shifted from 231 SF Per Worker (17-year average) pre-pandemic and is starting to stabilize at 180 SF Per Worker post-pandemic.
- In order for the South Brooklyn market to stabilize to a **New Fundamental Equilibrium**, approximately 1.5M SF, or 7.95% of existing supply, needs to either be taken off-line or repurposed to an alternative highest & best use.
- Extrapolating this downward adjustment to the nationwide supply of office (~8.5 Billion SF), **~676 Million SF needs to either be taken off-line or repurposed to an alternative highest & best use.**



Residual Demand vs. Average SF Per Employee



Commercial Real Estate What Is Not Being Discussed

Climate Change & Insurance Premiums



- Major insurance companies are reducing coverage or completely withdrawing from regions prone to natural disasters. In California, insurers have ceased issuing new policies in certain high-risk zones.
- Homeowners in high-risk areas are experiencing substantial hikes in insurance premiums. Between 2020 and 2023, average **premiums rose by 33%, with some regions facing increases up to 60% due to heightened climate risks.**
- According to The Deloitte Center for Financial Service, average monthly cost of insurance for a commercial building in the United States **could increase from \$2,726 in 2023 to \$4,890 in 2030, reflecting an 8.7% CAGR.**
- The links between climate change, the proliferation of extreme weather, and the rising costs to insure commercial real estate will likely remain for the foreseeable future...**owners must adapt, and even gain a competitive advantage, in this time of extreme transformation.**



Commercial Real Estate What Is Not Being Discussed

Climate Change & Insurance Premiums



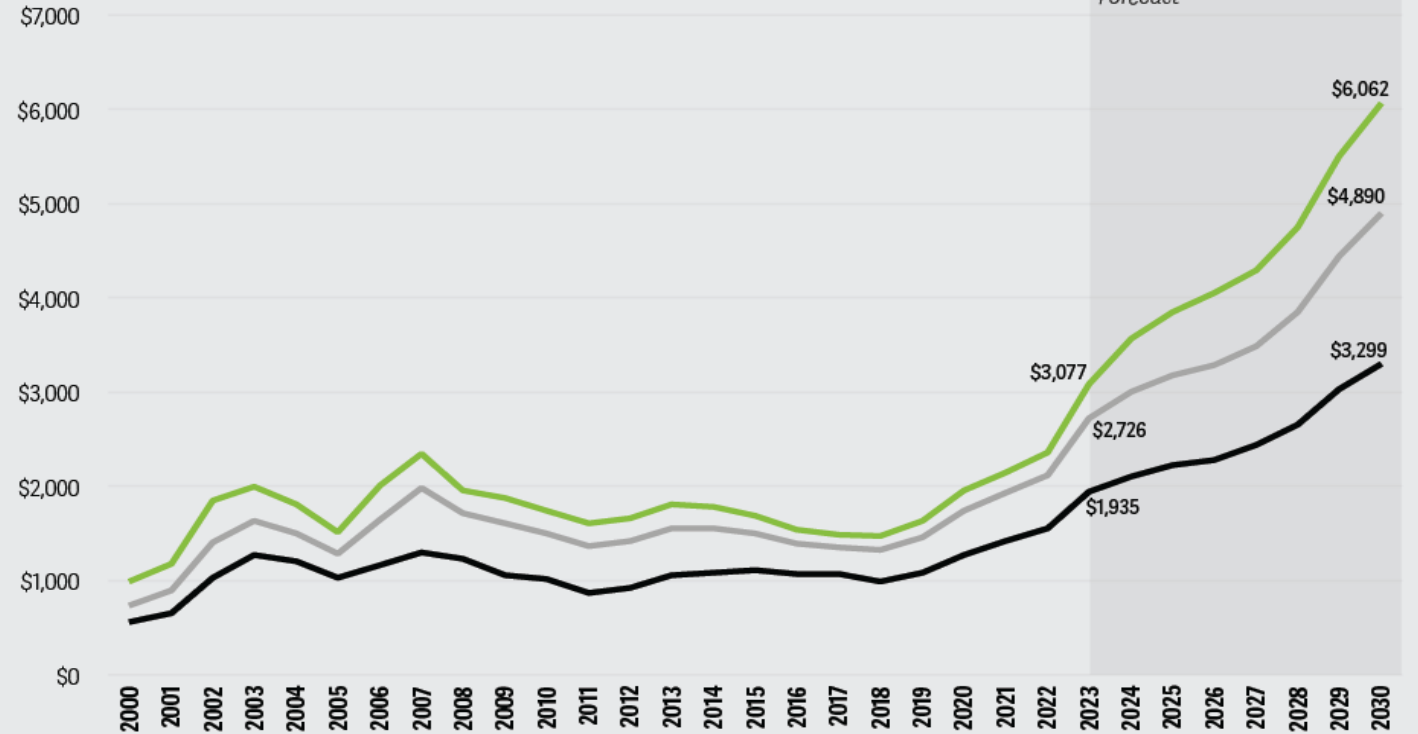
Figure 1

Insurance costs forecasted to double by 2030 in states with greatest risks of extreme weather

In US dollars

● Higher risk ● Lower risk ● All states

Cost per building per month



Source: Deloitte Center for Financial Services analysis of NCREIF data.

Deloitte Insights | deloitte.com/insights



Commercial Real Estate What Is Not Being Discussed

Can We Support the AI Revolution?



- AI models necessitate substantial computational power, leading to increased electricity usage in data centers. In 2023, data centers consumed approximately 4% of the total U.S. electricity generation, a **figure projected to rise to between 4.6% and 9.1% by 2030**, driven largely by AI and machine learning applications.
- The U.S. electrical grid, **much of which was constructed decades ago**, is encountering significant infrastructure challenges, the escalating energy demands from data centers is potentially leading to reliability concerns and necessitating substantial upgrades.
- The grid is under additional stress from extreme weather events and the integration of renewable energy sources is complicating grid management and **highlighting the need for modernization and enhanced.**



VII. Survive to 2025?



Survive to 2025?

Warren E. Buffett



- **“It’s only when the tide goes out that you learn who’s been swimming naked.”**



Survive to 2025?

Sir Isaac Newton



- “It’s only when the tide goes out that you learn who’s been swimming naked.”
- **“To every action, there is an equal and opposite reaction.”**



Survive to 2025?

Mohamed El-Erian



- “It’s only when the tide goes out that you learn who’s been swimming naked.”
- “To every action, there is always opposed an equal reaction.”
- **“The world is on a bumpy journey to a new destination and the New Normal.”**



Survive to 2025?

Jerome H. Powell



- “It’s only when the tide goes out that you learn who’s been swimming naked.”
- “To every action, there is always opposed an equal reaction.”
- “The world is on a bumpy journey to a new destination and the New Normal.”
- **“We’re not simply going back to the economy that we had before the pandemic.”**



VIII. Closing Thoughts



Closing Thoughts

Professor Ness



- **Easy Money is Over – Tighten underwriting with conservative assumptions and rigorous due diligence to navigate higher rates and stricter lending standards.**



Closing Thoughts

Professor Ness



- **Easy Money is Over** – Tighten underwriting with conservative assumptions and rigorous due diligence to navigate higher rates and stricter lending standards.
- **Do We Want to be a Republic Anymore?** – The public trust in the federal government has been low for decades. In 2023, it was at 16%, one of the lowest points in nearly seven decades.



Closing Thoughts Professor Ness



- **Easy Money is Over** – Tighten underwriting with conservative assumptions and rigorous due diligence to navigate higher rates and stricter lending standards.
- **Do We Want to be a Republic Anymore?** – The public trust in the federal government has been low for decades. In 2023, it was at 16%, one of the lowest points in nearly seven decades.
- **COVID's Impact on our Next Generation** – Teach our kids to collaborate, not cancel. Be a Mentor. Hire our U of L Real Estate Minors.



Stay Connected Professor Ness



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Thank You!



Thank You for Your Time.

Happy To Take Any Questions.

