Real Estate Outlook

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Inflation winds blowing.

UBS

UBS Asset Management

Content

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Global overview

Stiff winds from capital markets.

Economies slowed in the third quarter, hit by supply-chain constraints and the Delta variant of COVID-19, while inflation accelerated. Real estate investment markets were strong, with investment volumes above pre-pandemic levels, yields falling across sectors and a good investment performance, led by industrial.

Market overview and outlook

Economy, a gentle whisper in the wind.

The global economy slowed in the third quarter, hit by a combination of supply chain constraints and the Delta variant of COVID-19. Business surveys reported that manufacturing production is lagging behind orders as firms try to cope with bottlenecks clogging the supply chain. These include shortages in computer chips, a lack of lorry drivers and disruption in global shipping. The eurozone bucked the global trend and economic growth accelerated slightly in 3Q21 to 2.2% QoQ, while growth weakened in both China and the US. Japan is also expected to report a slowdown in activity once figures are released. We expect the economy to pick up again in 4Q21 and moving into 2022 as supply bottlenecks ease, but this is far from guaranteed.

While growth slowed inflation remained high or has increased, with trends varying by country. Higher and more persistent inflation has seen market expectations for interest rate rises get brought forward and central banks turn more hawkish. Indeed, in November the US Fed announced that it will start to slow its asset purchases by USD 15 billion a month, while the Bank of England stunned markets by pulling back from an interest rate rise. Prior to the Global Financial Crisis, central banks emphasized that it takes 12-18 months for interest rate changes to filter through the economy and looked to act pre-emptively.

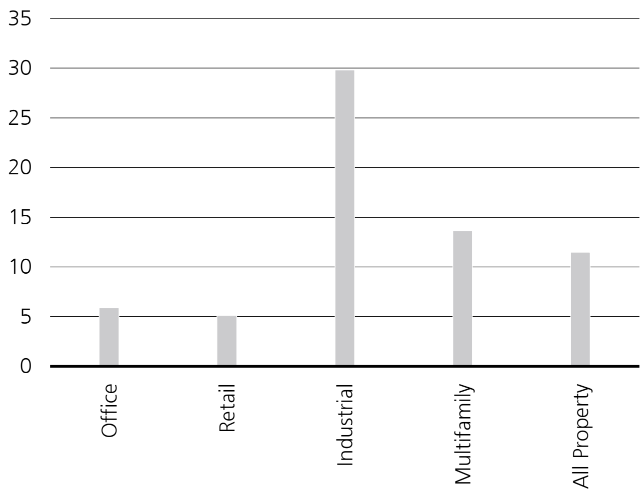
Ultra-low inflation over the past decade has changed the hymn sheet, with central banks now looking for economies to pass certain milestones before starting monetary tightening. This increases the chances of central banks acting too late and increases the risks of persistently high inflation. We still expect inflation to be brought under control in an orderly fashion though. At the moment, a small number of sectors are driving high inflation as relative prices adjust.

In real estate markets, global investment volumes continued their recovery. According to data from Real Capital Analytics in 3Q21 after allowing for seasonal effects global volumes were 15% above 4Q19 in USD terms. The Americas region has seen the strongest recovery, driven by the US, with volumes rising to 33% above their pre-pandemic level. APAC has also seen a good recovery, albeit less vigorous, with volumes back to 14% above pre-crisis levels.

By contrast, investment activity in EMEA remained 9% below pre-crisis levels, likely reflecting ongoing restrictions due to the virus and a less forceful economic rebound. Unsurprisingly, the industrial and residential sectors have driven activity globally, with strong investor interest in both sectors resulting in big capital value increases which have added to volumes.

Strong capital markets and investor demand were reflected in yield and cap rate movements. Within the industrial sector, yields showed further widespread falls in 3Q21, down in a clear majority (64%) of the 70 markets we monitor globally. Office yields also trended lower, falling in 25% of markets, with the bulk of the remainder showing no change. Retail markets were not immune to inward pricing movements. And, for the first time since 2Q18, yields and cap rates fell in more retail markets than they rose, dropping in 15% of markets and rising in just 5% of markets. The falls were focused on retail warehouses in Germany and shopping centers in Australia.

Figure 1: Global total return forecasts for 2021 (YoY, %)



Source: UBS Asset Management, Real Estate & Private Markets (REPM), November 2021. Past performance is not an indication of future results.

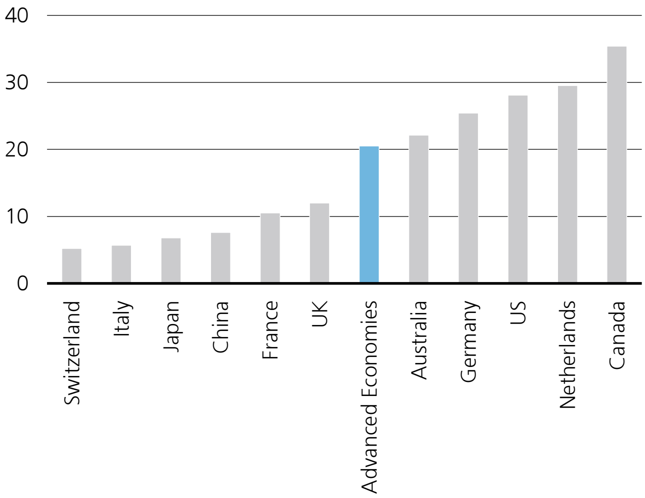
Performance in 3Q21 was also strong according to data from MSCI and NCREIF on Canada, Ireland, the UK and the US. Industrial maintained the very high returns seen in 2Q21 and in the US recorded total returns of 11% QoQ. Office and retail returns were lower and in the range of 1-2% QoQ across markets. UK retail bucked the trend with a 4% QoQ total return, driven by a strong recovery in retail warehouses. Multifamily was also strong, with total returns of 7% QoQ in the US. Overall, the market has been very strong this year and better than we forecast. We expect full-year global all property total returns of 11%, industrial to top out at nearly 30% and multifamily 14% (see Figure 1). We expect office and retail total returns to be more muted at around 5%.

Strategy viewpoint

Strong housing markets impact rental sector.

Housing markets around the world have had a strong showing during the pandemic. For example, Oxford Economics estimates that US house prices will have risen 28% by the end of 2021 compared to the end of 2019, while for the advanced economies overall they expect prices to have increased 20% (see Figure 2). Canada has seen the strongest price growth, predicted at 35% over the two years, followed by the Netherlands at 30%. Indeed, prices have shown an increase across all the advanced economies. Even in the weakest market, Spain, prices are thought to have achieved a 2% growth, against the backdrop of an economy ravaged by COVID-19.

Figure 2: House prices 4Q19 to 4Q21F (%)



Source: Oxford Economics; UBS Asset Management, Real Estate & Private Markets (REPM), November 2021. Past performance is not an indication of future results.

Several factors have driven strong housing markets over the past 18 months. Even before the pandemic, demand for housing was generally outstripping supply due to a lack of land and planning constraints holding back new developments in many markets. At the same time, demographic and socio-economic factors boosted demand. Although the pandemic brought strong headwinds, in the form of job losses, it also generated even stronger tailwinds. There was fiscal largesse from governments, such as tax incentives to support housing markets and help for those who lost their jobs or were furloughed. This was augmented by central banks providing stimulus in the form of abundant credit and interest rate cuts.

For real estate investors, it is important to understand the linkages between the mainstream private rented sector and the wider housing market. Ultimately, we see rental apartments and owner-occupied apartments as being substitutes for one another. Meaning, stock can be transferred between the two sectors, albeit with some time lags and hurdles to overcome. The investment price of an apartment is equal to its projected rental income discounted at the appropriate rate, given the risk factors and level of interest rates. The other factor to consider is the development cost of new apartments.

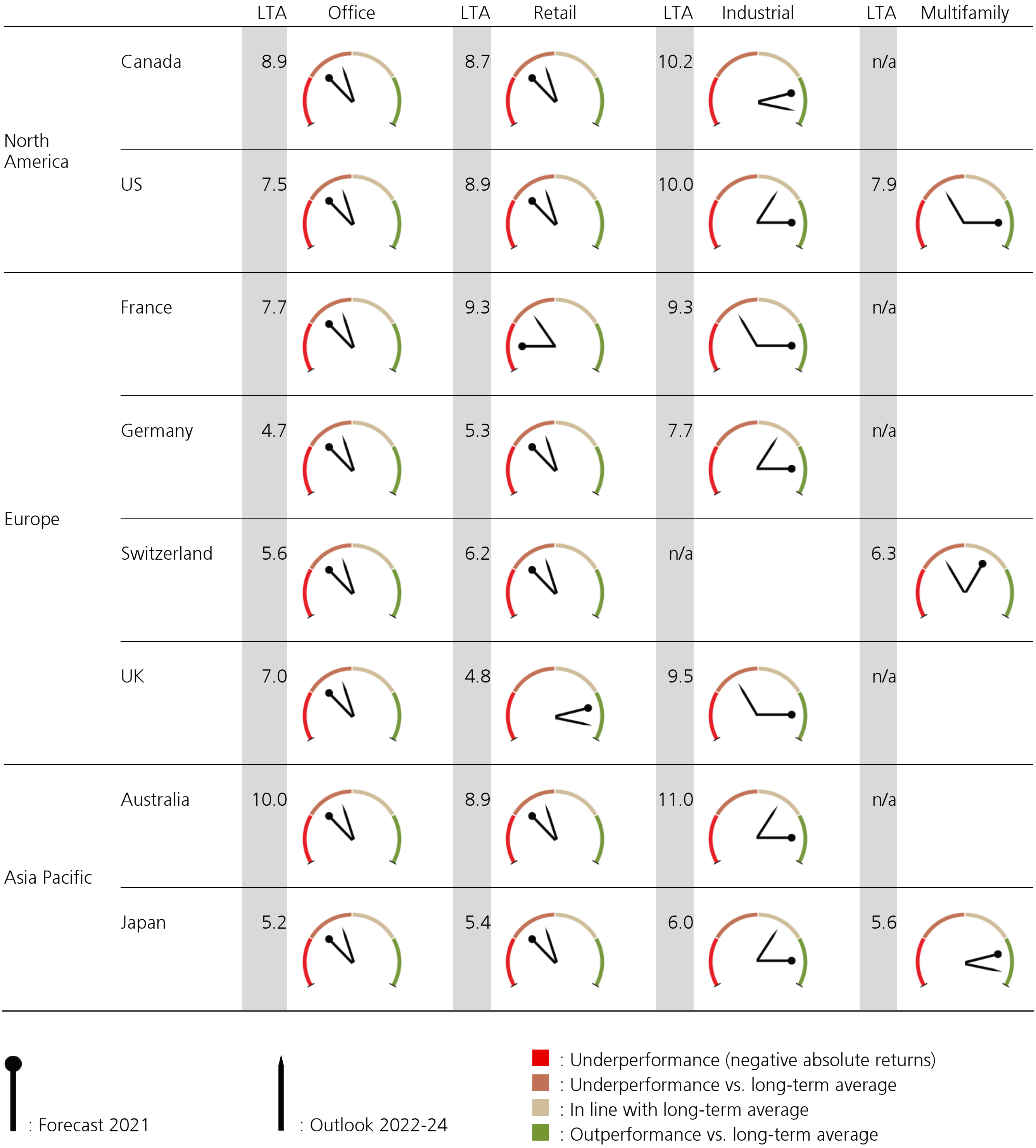
When the housing market is in balance, the total development cost of a new apartment should equal the price the asset would sell for on the investment market. This, in turn, should equal the price an owner-occupant would be willing to pay for the apartment. If this were not the case, opportunities would exist to generate profit by switching stock between sectors. For example, if the price of an owner-occupied apartment was higher than a rental apartment, it would cover the cost for owner-occupiers to buy apartments that are already rented out and change their use to owner-occupation.

Strong house price growth is pushing down multifamily yields and ultimately implies either that investors will accept slightly lower yields on residential investments or that they are relying on rising tenant demand to push rents and yields higher. The interlinkages between the markets means that the risk factors for the wider housing market are also likely risk factors for the rental market too. The key risk we see for owner-occupied housing markets is interest rates rising more quickly and to higher levels than expected. Given ongoing supply constraints, we do not think that supply is a key risk for the sector, but could play a role in specific micro-markets.

With prices high in mainstream housing and private rented markets, we think investors should broaden their residential portfolios by looking at niche and specialist residential property types. Potential areas include housing for seniors and retirees, aged care housing, affordable housing and student accommodation. We also think that rental markets in countries where institutional investment remains immature and low might offer attractive entry points and development possibilities. Overall, we continue to see opportunities in residential, but think that investors would do well to access the sector as widely as possible across its different facets and thus ensure good diversification.

Real estate investment performance outlook

2021 forecast and 2022-24 outlook are measured against the country-sector's long-term average total return, with the average +/- 100bps described as "in line with long-term average." The long-term average refers to the period 2002-20. The red underperformance quadrant refers to negative absolute total returns, either in the 2021 forecast or the 2022-24 outlook.



Source: UBS Asset Management, Real Estate & Private Markets (REPM), November 2021. Note: Abbreviation LTA: long-term average. Expected / past performance is not a guarantee for future results.

Fergus Hicks
Real Estate Strategist

APAC outlook

Investment markets blow strong.

APAC economies slowed in the third quarter. Apart from China, countries are now looking to contain COVID-19 rather than eradicate it. In office markets occupiers are adjusting to hybrid working arrangements, retail markets showed some signs of stabilization, while industrial and logistics showed rental growth across the region. Investment markets were strong, with yields mostly flat or falling.

Market overview and outlook

Investment activity recovers to pre-crisis levels.

APAC's economic recovery paused in the third quarter, led by a slowdown in China where growth eased to 0.2% Qu from a 2.4% expansion in 2Q21. A number of factors weighed on the Chinese economy – weaker house building as developers deleveraged, electricity supply disruptions and the impact of COVID-19 outbreaks. Growth in Hong Kong was less than expected, at just 0.1% QoQ, while the latest forecasts from Oxford Economics show significant declines in GDP in Australia and New Zealand in 3Q21. Japan and South Korea are expected to show only modest growth of below 1% QoQ. However, we expect the recovery to regain momentum in 4Q21 and moving into 2022 as supply bottlenecks ease.

Compared to North America and Europe, the roll-out of vaccines in APAC has been much slower. Governments initially targeted zero-COVID-19 policies aimed at eradicating the virus rather than containing it. However, in both areas there has been change. Vaccination rates have picked up and are now not so different from other regions and, apart from China, governments are moving away from zero-COVID-19 policies. They are now looking to live with the virus rather than get rid of it entirely. This is leading to a gradual easing of travel restrictions, which could provide a much-needed boost for the region's tourism sector.

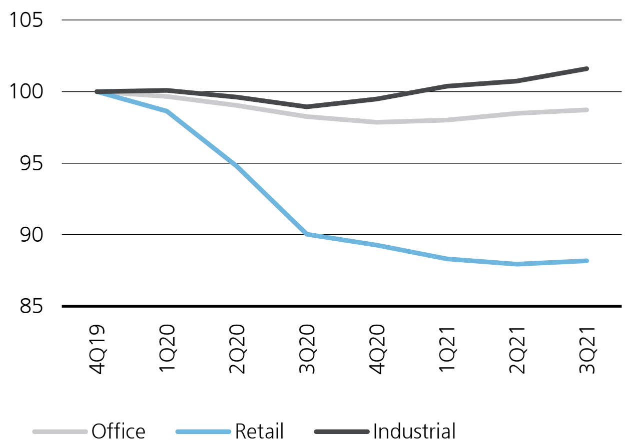
Conditions in office markets are mixed as corporates adjust to new hybrid working arrangements. Hong Kong and Tokyo were weaker markets in 3Q21, where CBRE reported falls in rents and rises in vacancy rates. Conditions in Hong Kong have improved from the deep downturn though, with new leasing demands from firms relocating and downsizing. The Singapore and Australia markets were stronger, but held back by new lockdowns. Beijing and Shanghai were also stronger and CBRE reported record net absorption for both of these markets in 3Q21. Seoul was the strongest market, where CBRE reported a fall in the vacancy rate and rise in rents as occupiers expanded.

etail markets showed some signs of stability and, according to CBRE, prime high street and shopping center rents were flat or stable in most major markets in 3Q21. Shanghai bucked the trend and rents rose. There have also been small pockets of strength. For example, according to CBRE rents for large format retail in Australia were up 10% YoY in 3Q21. The electronics and household sectors in Australia have seen strong demand as people have upgraded their homes.

However, retail remains challenged overall. Travel restrictions are hitting the luxury and premium segments hard. This left the market reliant on domestic consumption, which continues to be hit by lockdowns and faces ongoing incursions from the ever-rising shares of online sales. A pre-requisite for a durable and broad recovery in the retail sector will be a full re-opening of international travel.

The industrial and logistics sector continues to be strong and CBRE reported rental increases across the region in 3Q21 (see Figure 3). The ongoing shift to ecommerce continues to create demand for warehouse space from logistics companies and retailers. Vacancy rates are generally low, which is putting upward pressure on rents. Indeed, a lack of available space is also holding back leasing activity in Hong Kong. A recovery in global trade volumes is also boosting tenant demand.

Figure 3: Asia Pacific prime rent indices (local currency, 4Q19 = 100)



Note: Indices refer to 9 cities across 6 countries.
Source: CBRE; PMA; UBS Asset Management, Real Estate & Private Markets (REPM), November 2021.

The investment market was strong and CBRE reported yields across sectors and countries as mostly flat or falling in 3Q21. It was notable that retail yields in Australia showed some declines, indicating that the market may be leveling off. APAC investment activity was strong in 3Q21 and, after adjusting for seasonal effects, rose back to pre-pandemic levels in USD terms and exceeded them by 14%. The rebound was driven by strong growth in the industrial and office sectors.

Strategy viewpoint

In China leaves don't fall, they fly.

Investors and managers are frequently asked what keeps them awake at night. There is no doubt that events unfolding in China took up much of everyone's mental bandwidth in the last few months. From the crackdown and scrutiny of various sectors in technology and education, to mounting fears of global financial contagion due to the debt woes of a property firm, investors are left pondering the landscape in China over the next few years. We are not political analysts and do not intend to put forth views on geopolitical developments. We do, however, seek to offer some clarity here on what the new China playbook will look like for property investors.

China is focused on achieving its long-term domestic goals of a more equal society with improved social welfare, better public services, and a stronger social safety net, amongst others. In order to realize these, Beijing will need to balance macro risks and social threats in parallel. And what we have experienced in the past months are mostly policy actions and responses that will nudge China towards these end goals.

Evergrande's over-leverage is symptomatic of the financial time-bombs already ticking in the Chinese economy. This was not something unexpected. China does not want to encourage further risk-taking and debt loading of companies should it bail out Evergrande. It also wants to ensure an orderly resolution of the issue to calm sentiment, keep the property market stable, and soothe affected homebuyers.

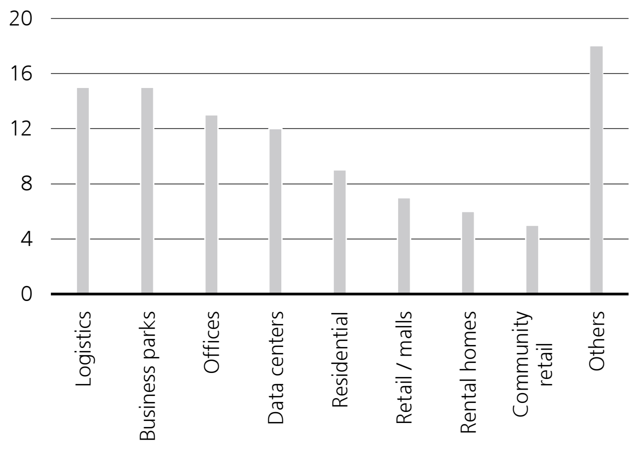
This balancing act is delicate in the short-term, but the longer-term stability offers much scope for real estate investors. The question is not whether investors should get exposure to Chinese real estate, but rather the forms and formats of real estate in China they should target going forward.

What the current climate is projecting is not a reflection of the structural prospects in China, which are still appealing on a selective basis. We believe a few themes will endure in the medium to long-term and investors would do well to get exposure to these.

First, assets that serve the New Economy are poised for long-term growth. *What is the New Economy?* These are high growth industries that sit at the fringes of technology and productivity and have strong policy support from the government.

Other than offices and logistics that lean heavily on technology and e-commerce, we think business parks, R&D facilities, data storage facilities and high-end manufacturing will do well in the New Economy narrative. According to Colliers's 2021 investor survey (see Figure 4), investors are almost equally split between their preferences for logistics, offices, business parks and data centers.

Figure 4: Investors' asset type preference in China (%)



Source: Colliers Radar, September 2021

Second, alternative niches such as cold storage, healthcare and multifamily will become mainstream in the years to come. This is less a prediction than an actual development. These niche sectors require higher levels of operational capabilities, but are underpinned by real demand. This is especially so given the accelerated changes in socio-demographic trends and preferences.

Third, the pressure on Chinese developers to ease up on leverage is intense and there is a crucial impetus to bolster balance sheets. Many developers are now open to disposing of their non-core commercial property assets. We believe this creates a tactical window for investors to gain access to a market that is traditionally tight on asset availability.

Last, and more broadly, the Greater Bay Area (GBA) is a metropolitan cluster that should see synergistic growth in the next decade. Real estate investors would do well to leverage on consumption and employment growth in the GBA, on top of its solid base of population.

Zachary Gauge
Head of Real Estate Research
& Strategy – Europe ex DACH

European outlook

Will the leaves return?

With inflation back with a vengeance and central banks set to raise rates over the next 12 months, investors can no longer depend on the buy and hold model to deliver strong returns. Capex and sustainability requirements are going to weigh ever more heavily on NOI, but with property yields at ultra-low levels there is little buffer should a downside scenario play out. The asset class can still deliver strong returns, but managers will need to work harder to create genuine value from their real estate investments.

Market overview and outlook

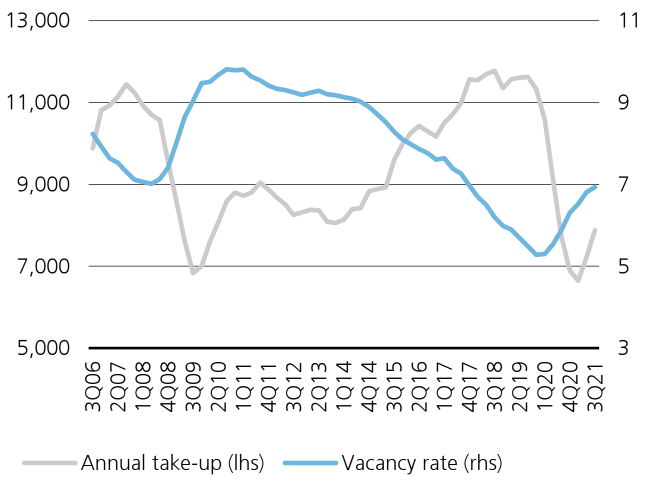
Inflation dominates discussion.

Economy

After the positive momentum which grew with the reopening of economies in 1H21, disrupted supply chains came under pressure in 3Q21. The consequence of this has been a sharp increase in inflation, which hit 4.1% in the eurozone in October and 3.1% in the UK in September. Both are expected to continue to rise, with UBS Investment Bank expecting the eurozone to hit a peak of 4.3% in November and Oxford Economics forecasting that the UK will reach 4.5% by the middle of next year. The vast majority of price increases continue to be either directly or indirectly linked to the impact of the pandemic, so we expect the higher levels to prove transitionary and fade away over the next 24 months.

But in response to the acceleration in economic growth and the potential threat of higher inflation, central banks have turned noticeably more hawkish. Markets are now pricing in the Bank of England to raise rates to 0.5% by the end of next year and are even anticipating a hike from the European Central Bank of 20bps by the end of 2022. Interest rates will remain at historically low levels, but pose a threat to the asset-price bull run, which has been fueled by falling interest rates over the past decade.

Figure 5: European office take-up and vacancy rate
('000 sqm, %)



Source: JLL, 3Q21

Occupier markets

The vacancy rate for European office markets continued to move up in 3Q21, although at a slower rate than previous quarters (see Figure 5). Interestingly, vacancy in the UK markets actually reduced slightly as some of the sub-lease space was taken off the market.

Demand continued to recover but remains well below pre-pandemic levels. Most occupiers are waiting to see how the return to office goes before making decisions. Prime retail markets continued to show signs of stabilization according to data from CBRE, with rents flat in most markets. Those which did see declines included the regional French and Netherlands markets. Demand for logistics space in 2021 is likely to hit another record high, driven in part by ecommerce which accounts for about 25% of the market. Unlike previous quarters, the supply-demand imbalance is starting to generate more widespread rental growth – markets in Germany, France, Belgium, Netherlands, Spain and the UK all recorded some quite strong growth in 3Q21.

Capital markets

Transactional activity in Europe continued to be fairly resilient in 3Q21 according to data from Real Capital Analytics, with quarterly volumes down by about 17% on the 2019 level. Investor appetite amongst institutional European investors remains strong, although travel restrictions continued to make it difficult for non-European buyers to transact. In particular, for family offices and HNW from Asia who typically need to see the asset before purchasing.

The sectoral composition of the investment universe continues to move away from the more traditional asset classes of offices and retail, and into logistics, residential and other alternatives. Within the office sector investors are still active, but heavily focused towards the core end of the market, where yields are continuing to compress. Prime retail yields are generally stable, although sentiment remains very weak outside of this segment and valuations should continue to move out in Europe. One exception is the UK, which has seen by far the sharpest correction. However, the UK is now seeing some stabilization and in the retail warehouse segment some very significant recovery in capital values. PRS yields remain at very low levels.

Property markets in Europe can no longer rely on falling interest rates to drive yield compression. And current yield levels represent very low returns. Our view is that investors will need to work much harder to generate the level of returns which they've enjoyed over the past decade in Europe, by creating real value from the real estate they own. With rising capex and sustainability requirements, the buy-and-hold model is likely to come under increasing pressure, particularly if inflation does prove higher and interest rates move out more quickly than anticipated.

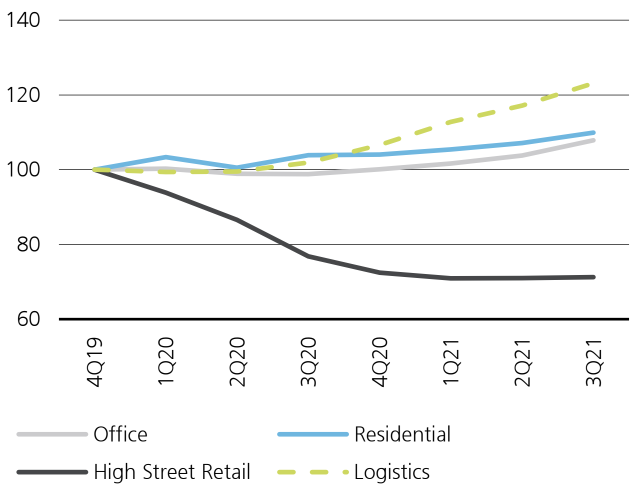
Strategy viewpoint

Fallen leaves are nature's trick or treat.

Post-pandemic winners are *too obvious*

With structural trends accelerated by the pandemic, capital has flocked to those sectors best positioned to benefit – namely *beds, sheds and meds*. But the consequence of a vast amount of capital being pushed towards select sectors of the real estate universe is rapid price inflation. Prime industrial capital values have increased by 23% since 4Q19, whilst prime PRS values are 10% higher and yields below 2.5% in some parts of Europe. Assets with a life sciences angle have been sold at 60% above their original quoting price.

Figure 6: Prime European real estate capital value indices (4Q19=100)



Source: CBRE ERIX, 3Q21

However, what is more surprising is that the office sector, which is facing rising vacancy rates as a major structural shakeup takes effect, has also seen prime office values increase by around 8% since the start of the pandemic (see Figure 6). Although we believe in the long-term future of the office, the downside risks are not just associated with a structural shift to more homeworking. Capex costs have inflated rapidly, and with vacancy increasing tenants are in a strong negotiating position. They are still actively seeking space, but requirements are increasingly focused on assets which specifically match their post-COVID-19 requirements. Buying a prime asset in the current market and hoping for the market to move in your favor could cause severe difficulties as the interest rate environment turns. Investors will have to add value to their assets to remain competitive and achieve rental growth, which will only be realized in an increasingly narrow segment of the market.

Where do we see value?

The income value approach would indicate that some interesting opportunities in retail will emerge. Initially, these will be highly selective and focused on the assets where rents have fallen to a sustainable level in locations that retailers continue to trade well in and remain profitable. Initial returns are driven by the much higher income yields which are now available due to the very weak sentiment surrounding the sector. However, there is also scope for some inward yield shift as the sector recovers some of the lost ground. We are already seeing this in the retail warehouse segment of the UK market, which has recorded 7.2% capital growth during 1Q-3Q21. In Europe, the retail correction has been less significant so there is less capacity for a recovery. But again, focusing on retail parks, income returns are high, particularly in Southern Europe. And for the parks which offer a functional product range and affordable rents to occupiers, we see some upside in the coming years.

For a strategy focusing on growth, although it is highly demanded, we do see further opportunities in European life science assets. The key difference between the traditional office market is that work done on R&D sites cannot be replicated by a home office. As venture capital has poured into the sector, many companies require real estate to expand into but there is very limited, if any, available specialist space in the location in which they are active. So, although the entry yields may seem low, there is a case for very strong rental growth which can justify them. The sector is also relatively de-centralized, with hubs emerging outside of the traditional core office markets and around key employers and universities where there is a focus on specific areas of research. Although there are risks on liquidity, these locations can again prove very defensive as the employees typically have a very specialized skill set which underpins the research and manufacturing attributes of that specific micro-location. And being outside the core markets means the entry yields also become more generous.

And for a niche sector play, we believe there are strong opportunities for growth in the European student accommodation market. The supply-demand dynamics are extremely positive, partly driven by an increasing number of non-EU students who are attracted by the rising number of English taught courses in Europe. The UK market has demonstrated that a significant pipeline of new rooms can be easily absorbed in strong university locations. Further, being an early mover creates an opportunity to be at the forefront of a sector which is set to grow considerably over the next decade and benefit from a stable income return supported by a supply-demand imbalance.

Kurt Edwards
Head of Real Estate Research
and Strategy – US

US outlook

Frosty nights and sunny days.

US GDP has exceeded pre-pandemic levels, although cooling somewhat during third quarter. Continued healthy growth is anticipated into the new year. The apartment and industrial sectors continue to outperform and the retail sector is on the mend. However, office sector performance is causing concern.

Market overview and outlook

Autumn's harvest bears fruit.

The NCREIF-ODCE Fund Index saw a positive total return of 6.6% for the quarter – the highest quarterly total return on record – and 14.6% for the year ending 3Q21. With the exception of hotels, all sectors experienced positive quarterly returns in 3Q21. This was largely driven by record industrial appreciation returns.

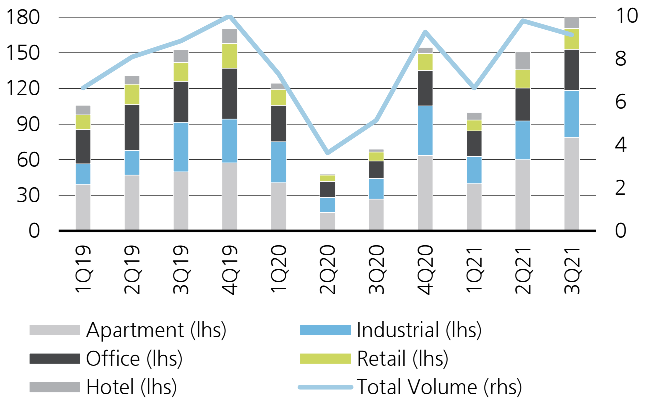
Multifamily and industrial continue to post outsized returns relative to the other sectors. However, fundamentals within the strip-center component of retail seem to have bottomed out as demand for restaurants and health/fitness services has increased. Green Street reported positive revisions to year-end public strip-center REITs NOI/FFO guidance. Office demand continues to be in question and may push more investors to price a premium on higher quality (i.e., newer product) and well-located assets in a *flight-to-quality* movement.

The primary property sectors all saw total returns on an annual basis accelerate over the quarter (see Figure 8). Industrial returns continue to exceed the other sectors, accelerating to nearly triple that of one year ago. Office returns have maintained modest improvement. Retail returns turned positive for the first time since 2Q19. Apartment returns accelerated to the highest level since 2016. At the market level we forecast a strong growth pace for industrial and apartment returns, but modest performance for office and retail for 2021 overall.

Apartments: Demand set new records in 3Q21, pushing vacancy down to 2.9% and rent growth up to 6.2% QoQ, according to CBRE-EA. We expect the pace of construction to accelerate in the coming quarters, normalizing vacancy rates and rent growth.

Figure 7: Transaction activity

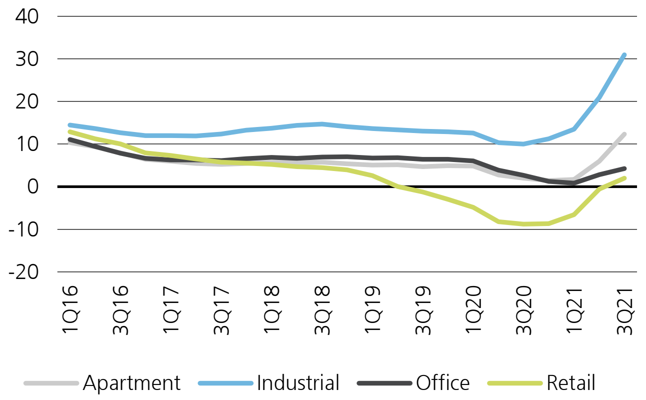
Volume (USD billion) Count of properties ('000)



Source: Real Capital Analytics as of September 2021, totals include entity sales and are not adjusted for seasonality.

Figure 8: Total returns at property level for ODCE funds

(YoY, %)



Source: NCREIF as of September 2021. Data show unlevered NCREIF Property Index total returns filtered for only ODCE managers. Past performance is not a guarantee for future results.

Transaction volume in 3Q21 (measured in USD) exceeded that of both the third and fourth quarters of 2019, driven by apartment trades. A modest decrease in the number of properties traded overall indicates a general rise in pricing (see Figure 7). Investors are taking advantage of increased market liquidity to update portfolio positioning.

Interest rates remain low and support increasing transactions. Spreads available in private real estate remain near long-term averages. Borrowers have options as lenders become more competitive, especially for high-quality credit, long-term leases, multifamily and industrial properties.

Industrial: Rolling annual completions remain near 2% of stock, yet availability continues to decline. Rent growth remains strong, at 4.4% in the year ending 3Q21, according to CBRE-EA.

Office: Total vacancy continues to rise, reaching 16.8% in 3Q21. Development has not slowed and asking rent declines are forecast to continue through mid-2023.

Retail: The most vulnerable businesses are those unable to adapt to online or app-based strategies. Neighborhood & community center availability is down by 50bps for the quarter to 8.3% as of 3Q21 according to CBRE-EA, while rent growth remains positive.

Strategy viewpoint

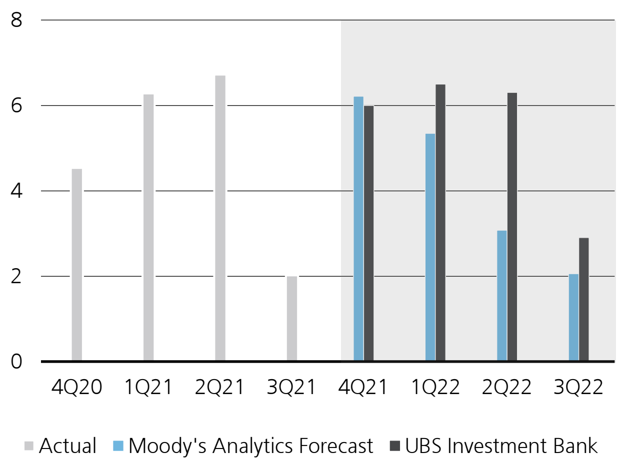
Cold winds, slow growth.

The US economy saw strong recovery growth throughout the first half of the year, exceeding the pre-pandemic GDP level by 2Q21. GDP growth in 3Q21 fell short of forecasts, reaching 2.0% annualized but is expected to pick back up at year-end (see Figure 9).

Effects of COVID-19 are continuing to moderate since a peak of US hospitalizations was reached in early September as new approvals for vaccinations for 5-11 year olds (9% of the population) were approved by the FDA on 29 October 2021. Seven-day moving average levels of booster shots surpassed first and second dose vaccine administration, and are expected to continue to outpace them.

UBS Investment Bank is projecting US GDP growth to deliver strong above-trend growth over the next few years driven by accommodative monetary policy, continued recovery in employment, healthy household balance sheets with pent-up savings, and further fiscal stimulus (see Figure 9). The October jobs report posted an increase of 531,000 in employment and strong revisions for August and September to much higher levels (483,000 and 312,000, respectively).

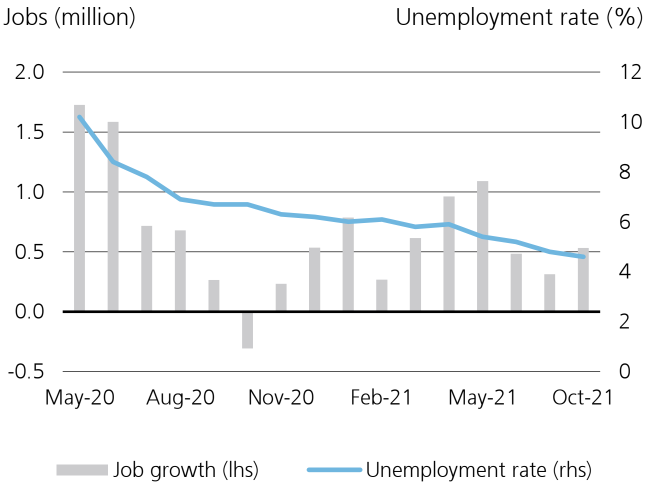
Figure 9: GDP quarterly annualized forecast (%)



Source: Actual from Moody's Analytics, 28 October 2021; Moody's Analytics forecast, 11 October 2021; UBS Investment Bank forecast, 8 October 2021. Shaded area indicates forecast data.

The monthly unemployment rate declined to 4.6% in October (see Figure 10), after holding steady near 6% throughout the first half of the year. As of 3Q21, the labor force participation rate remained 160bps below the 4Q19 peak; with more than four million fewer jobs than at the end of 2019.

Figure 10: Monthly job growth and unemployment rate



Source: Moody's Analytics, 5 November 2021

The US is experiencing faster job growth and more fiscal stimulus is being considered via the Infrastructure Investment and Jobs Act and the Build Back Better program. The market is still pricing a Fed driven interest rate hike in 3Q22 at the earliest.

The Fed continues to label the current inflationary environment as transitory, but may reassess if 4Q21 levels are above expectations. We continue to believe any surprise inflation that is more than transitory will affect capex heavy real estate sectors/sub-segments that do not have clear demand drivers (i.e., traditional office and malls).

Investor confidence remains higher in the industrial and apartments sectors, given the persistent, necessity-driven tenant demand. In retail, office and hotels, constrained transactions, and higher capex burdens make it difficult to assess whether current premiums compensate adequately for the risk.

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