

Commercial Real Estate 2017: Changes in the Air

GEORGE RATIU | @GeorgeRatiu

Commercial Economic Issues & Trends Forum

REALTORS® Legislative Meetings & Trade Expo | @NARLegislative

Washington, DC | May 18, 2017

What is a VCR?

What is a VCR?



- **V**ideo **C**assette **R**ecorder
- Developed in the 1960s; reached mass market in the 1970s
- VCR was the home TV recording tech of 1980s-90s
- 2016: VCR was officially out of production

Do you remember RZRs & Curves? iPhone's getting old...



- Motorola **RZR** – marketed 2004-**2007**



- BlackBerry **Curve** – introduced in **2007**



- 2017: iPhone turns 10 years old

May we live in interesting times...

TECHNOLOGY

Artificial intelligence
Autonomous vehicles
Sharing services
3D Printing
Biotech

INFRASTRUCTURE

Public roads
Transportation hubs

POLITICS

Presidential election
Congress
States / Cities

DEMOGRAPHICS

Gen X / Gen Y / Gen Z
Urban / Rural
Wealth disparity



MONETARY/FISCAL

Funds target rate
Federal budget

FINANCE

Capital markets
Fintech
Crowdfunding

GLOBAL

Economic weakness
Brexit/Nationalism
Migration
Wars/military conflicts

SOCIAL

Wealth disparity
Cannabis legalization

...as we swim in a sea of acronyms...

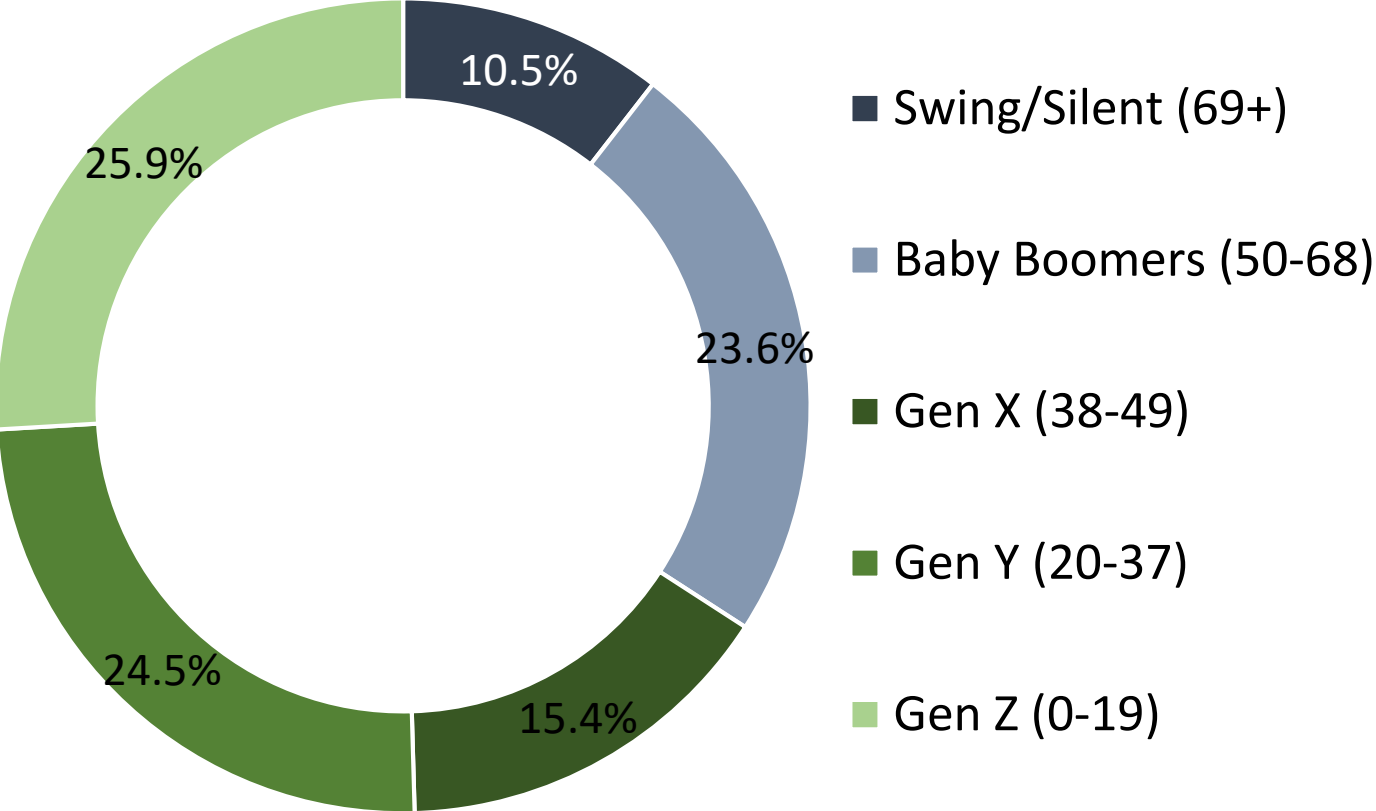
A word cloud of various financial and business acronyms. The acronyms are scattered across the page in different sizes and orientations. The largest acronyms include SAAS, CAPEX, DSCR, and CDS. Other prominent acronyms include GDP, NYSE, IRR, GAAP, LTV, and ROE. Smaller acronyms include B2B, ISM, EXP, BPS, P/E, EBITDA, NOI, CMBS, EPS, WTI, FOMC, DCF, \$/SF, DJIA, CDS, NPV, ROE, FX, OECD, LIBOR, P&L, ROI, WTO, ADS, CDO, CAP, IR, VAT, LOI, IMP, and NYSE.

SAAS
CAPEX
DSCR
CDS
GDP
NYSE
IRR
GAAP
LTV
ROE
B2B
ISM
EXP
BPS
P/E
EBITDA
NOI
CMBS
EPS
WTI
FOMC
DCF
\$/SF
DJIA
CDS
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CAP
IR
VAT
LOI
IMP

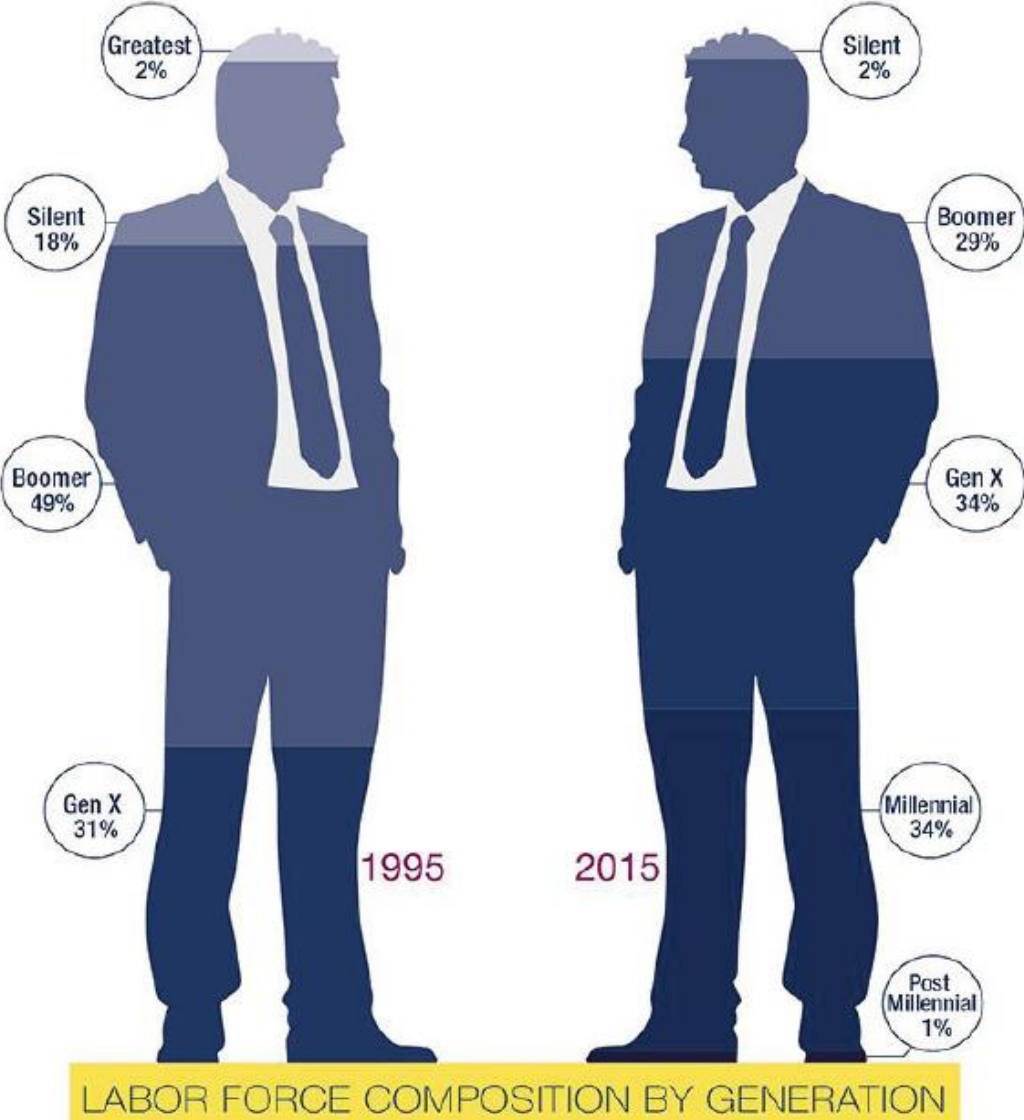
NYSE IRR SAAS WTO ROI P&L
GDP B2B CDO GAAP LIBOR
ISM LTV CAP ADS OECD
EXP IR **PEOPLE** FX CDS
BPS VAT ROE
P/E NOI LOI WTI FOMC NPV
EBITDA CAPEX CMBS EPS DSCR CPI
IMP DCF \$/SF DJIA

Demographics accelerate change

2017 U.S. Population by Demographic Cohort



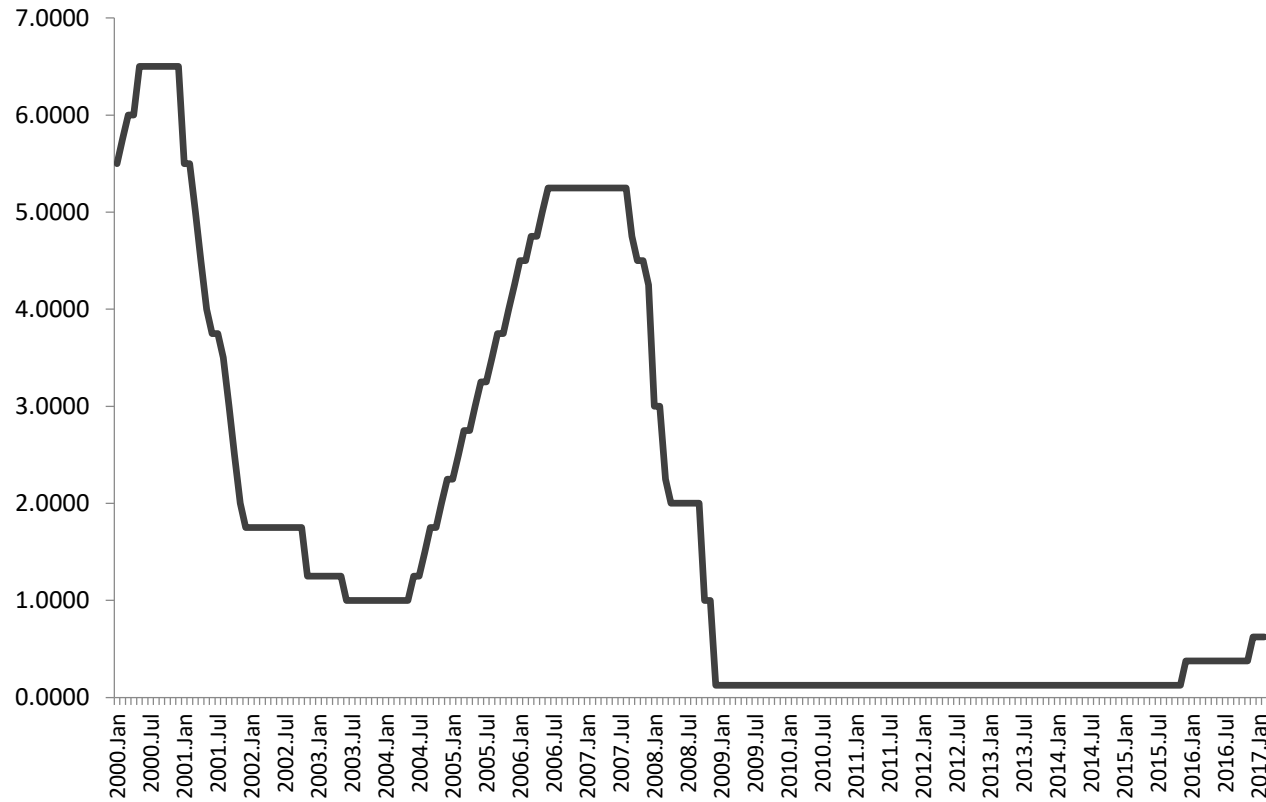
Source: Sparks & Honey



Source: Pew Research Center

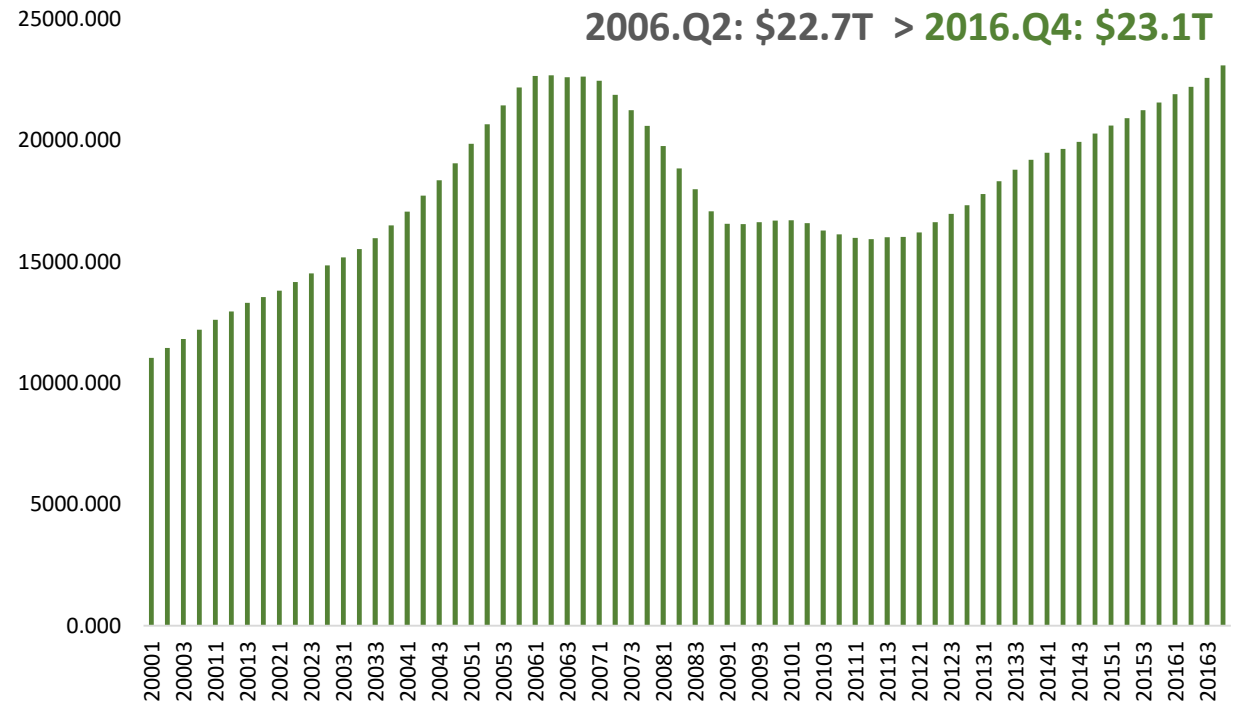
Monetary policy helped housing, hurt savings...

FOMC Fed Funds Target Rate (EOP, %)



Source: Federal Reserve Board

Households: Nonfinancial/Tangible Assets: Real Estate (NSA, Bil.\$)



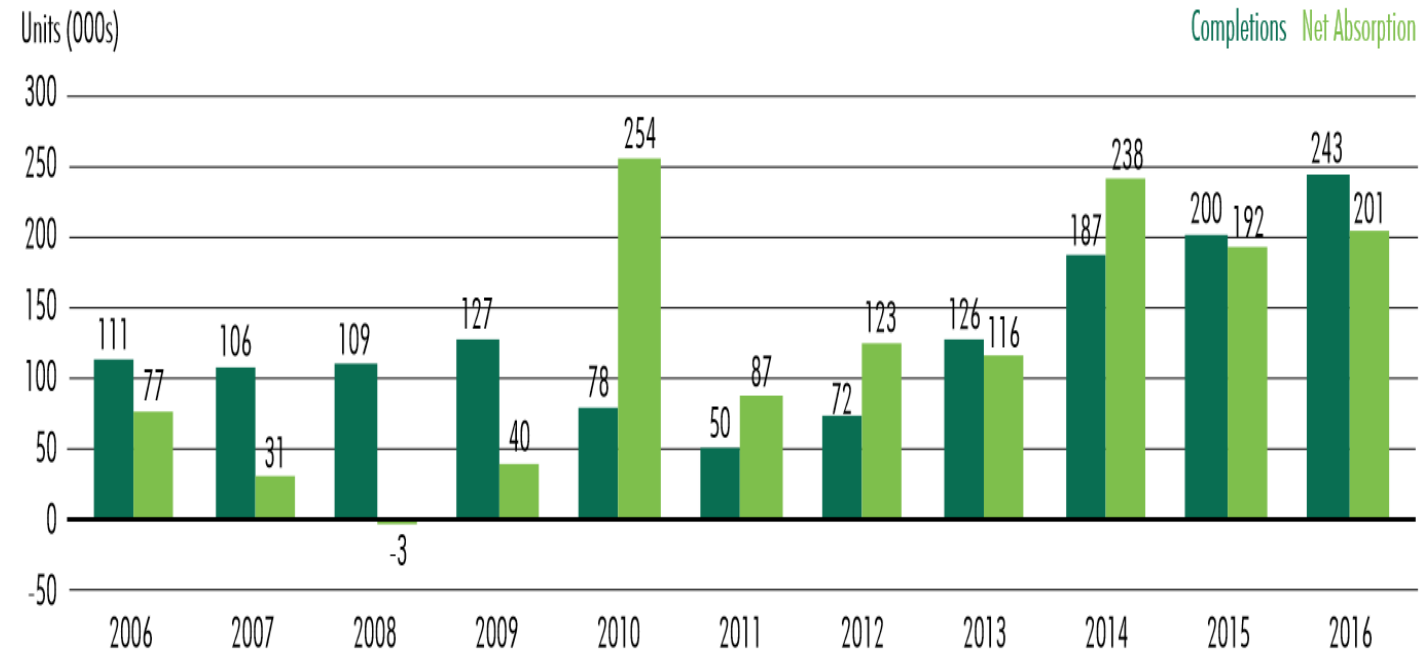
2006.Q2: \$22.7T > 2016.Q4: \$23.1T

Source: Federal Reserve Board

Multifamily demand follows population growth

- Mixed-use urban development; live/work/play
- Class A supply; small floorplans; amenities
- Demand remains robust; 2016 net absorption 201,300 units
- 2016 Completions: 242,800 units
- Vacancy moves up (4.9%), moderates rent growth
- Affordability declines

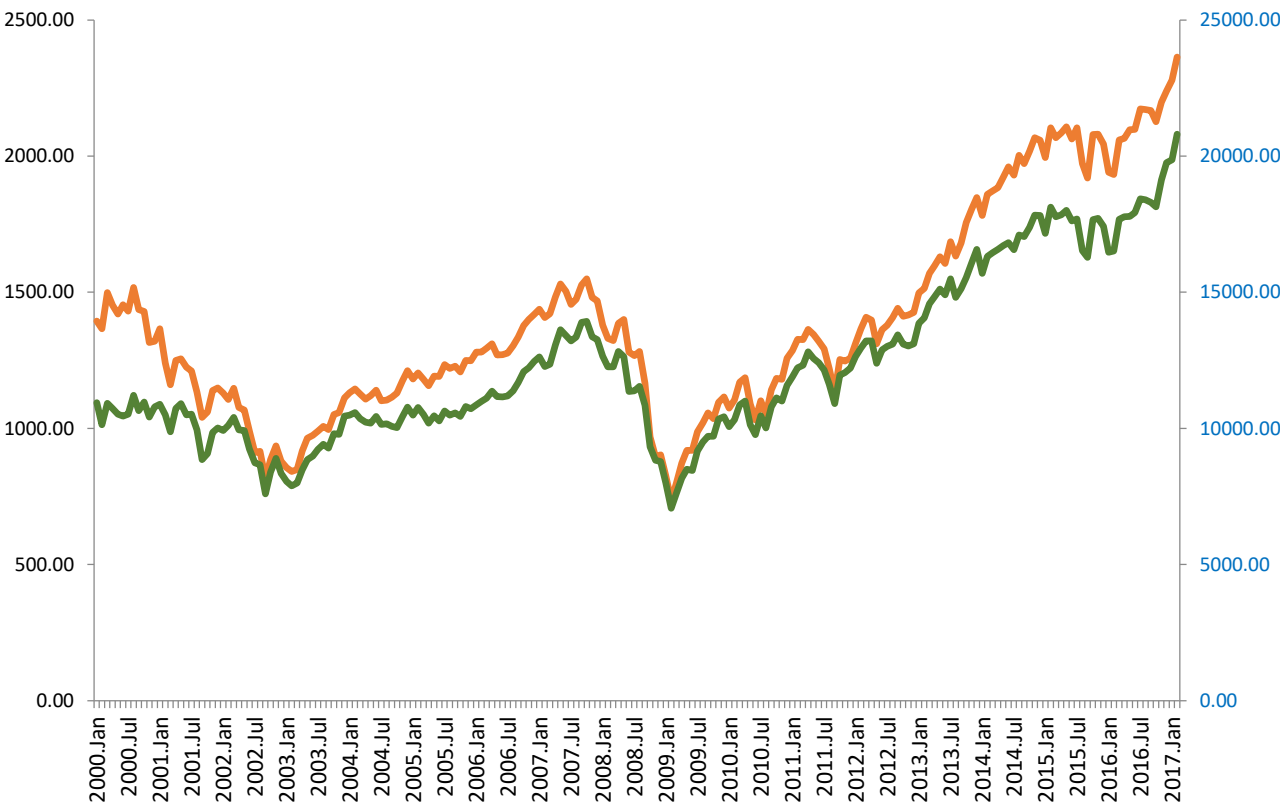
U.S. Multifamily Completions and Net Absorption



Source: CBRE Research, CBRE Econometric Advisors, Q4 2016. Note that new property completions and net absorption are counted in the quarter when the property reaches occupancy stabilization.

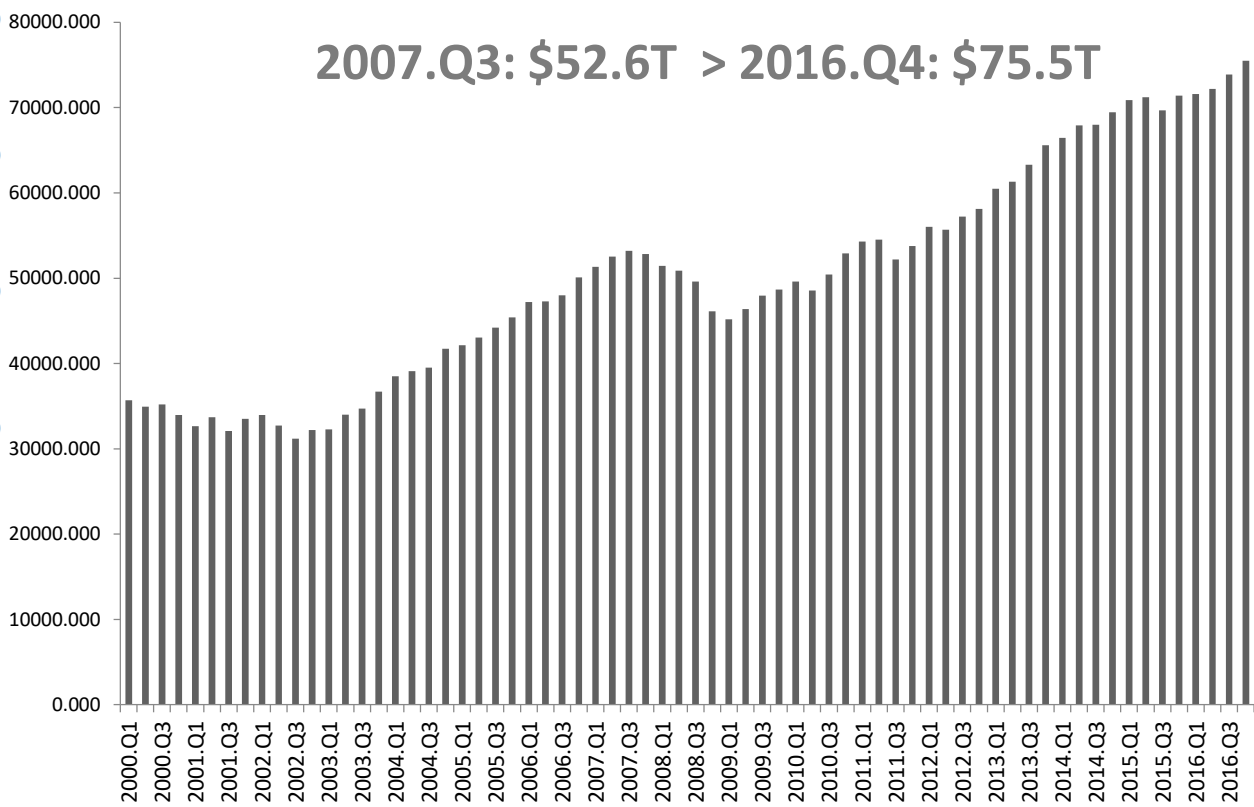
Bull market boosts household wealth

— S&P 500 (EOP, 1941-43=10) — DJIA (EOP, May 26, 1896=40.94)



Source: Wall Street Journal

Households & Nonprofit Org: Total Financial Assets (NSA, Bil.\$)



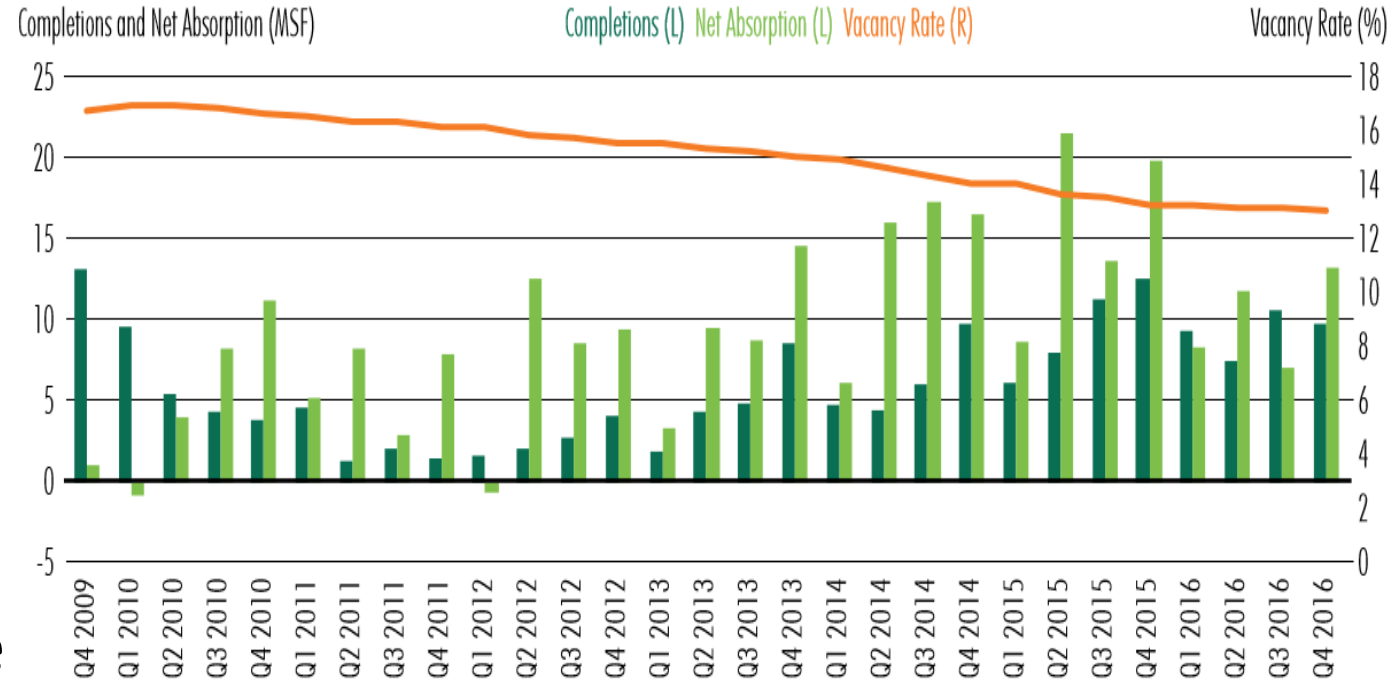
2007.Q3: \$52.6T > 2016.Q4: \$75.5T

Source: Federal Reserve Board

Office demand drives vacancy under 13%

- Payroll employment advances; professional & business svcs.
- Mobile workforce; increased telecommuting
- Space efficiency, flexible designs
- Sustainability tied to workforce retention & financial impact
- Positive net absorption + moderate completions = Vacancy @ 12.9%

U.S. Metro Office Supply and Demand

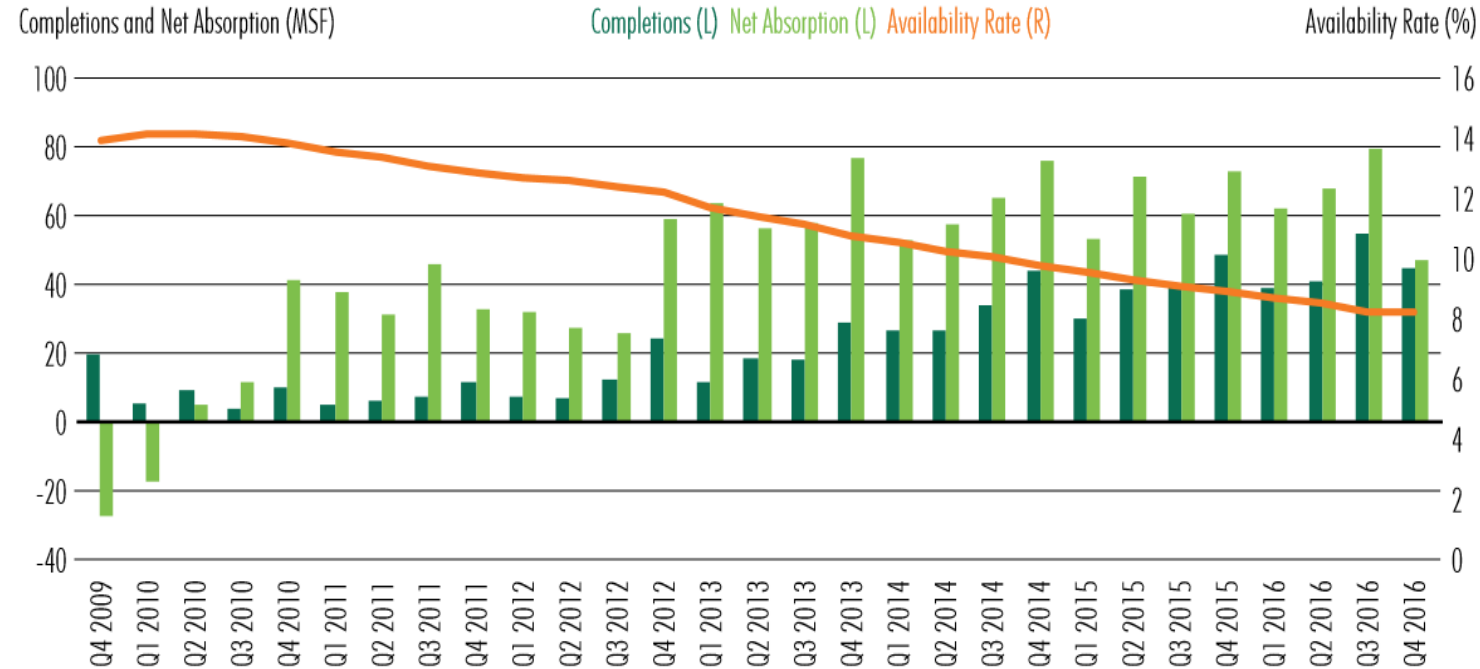


Source: CBRE Econometric Advisors, Q4 2016.

Industrial absorption boosts rents

- Increased trade
- Rising e-commerce
- “Last mile” distribution
- Intermodal logistics
- Panama Canal; East coast ports
- Net absorption: 256.7M SF
- Net rent growth accelerates, \$6.6 PSF

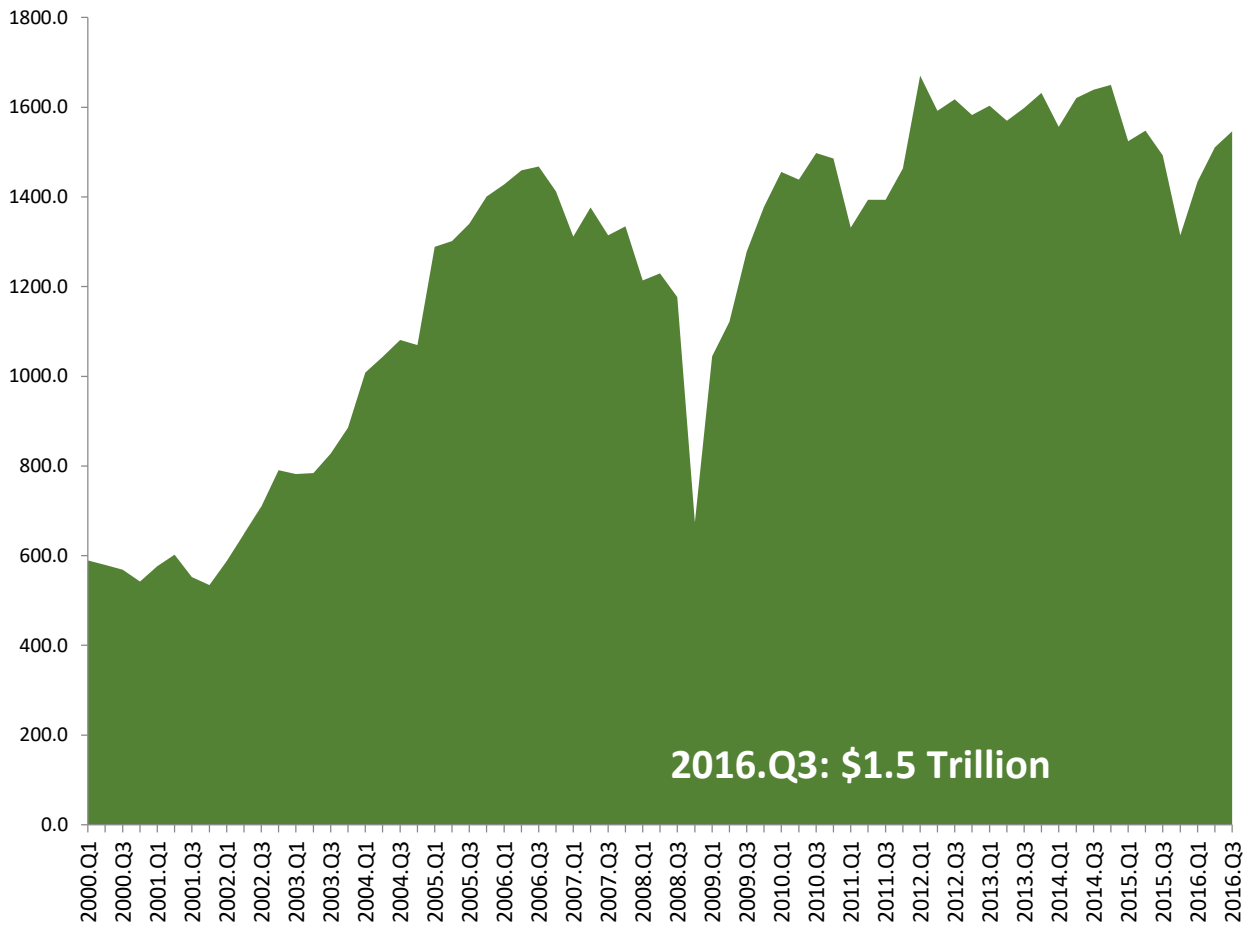
U.S. Industrial Supply and Demand



Source: CBRE Econometric Advisors, Q4 2016.

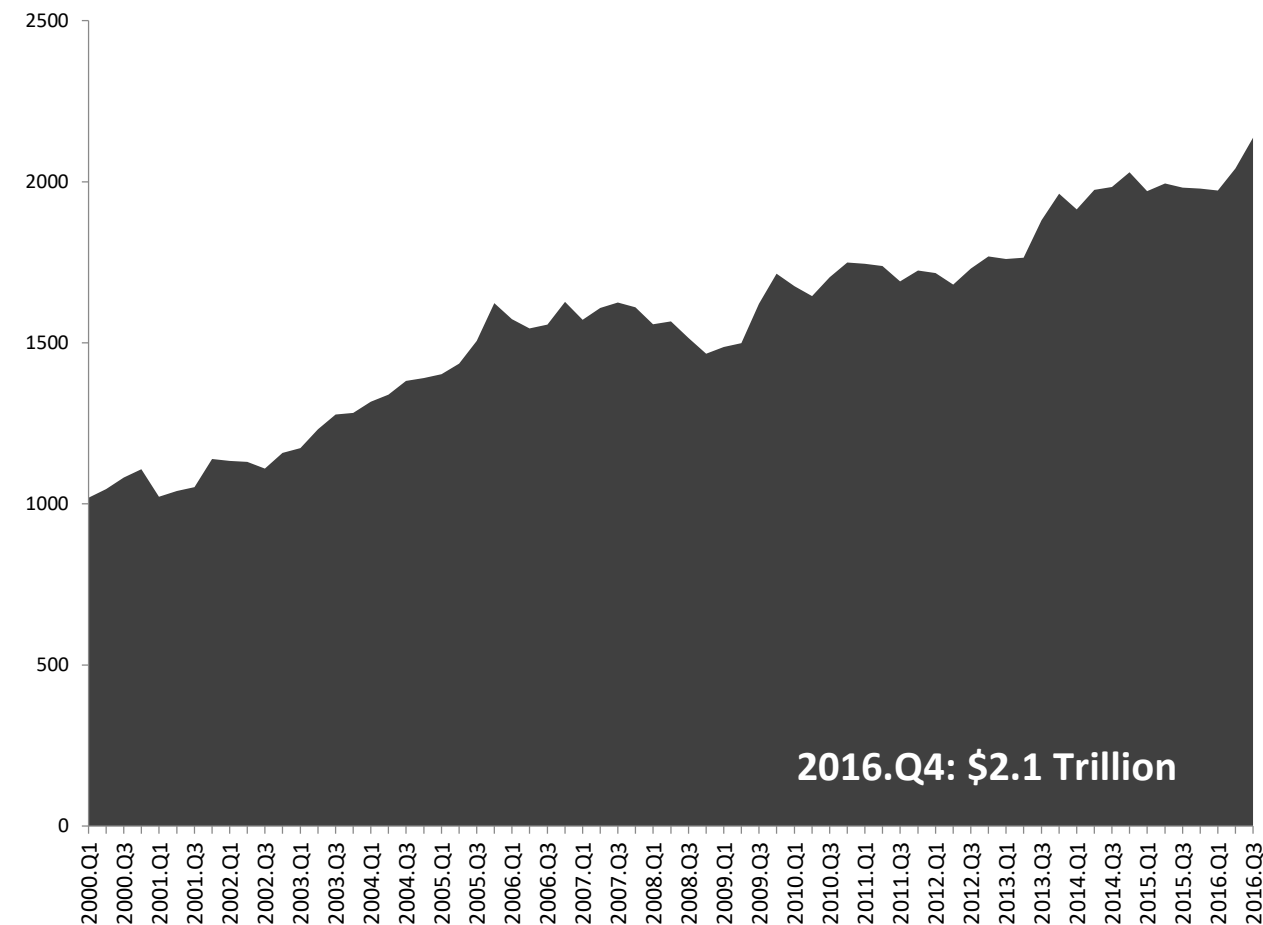
Corporations remain cautious

Real Corporate Profits After Tax (SAAR, Bil.Chn.2009\$)



Source: BEA

Corporate Cash/Cash Equivalent Holdings (NSA, Bil.\$)

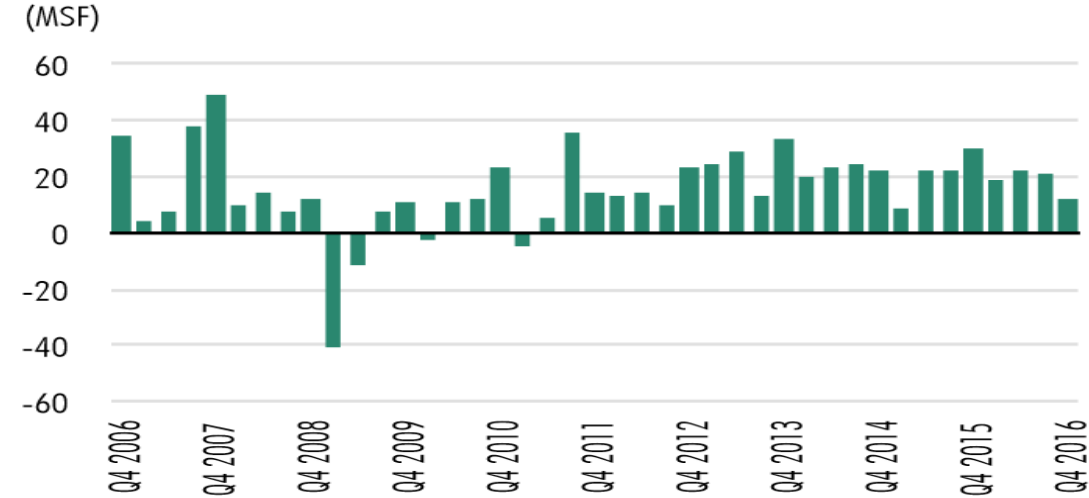


Source: Federal Reserve

Retail transformation

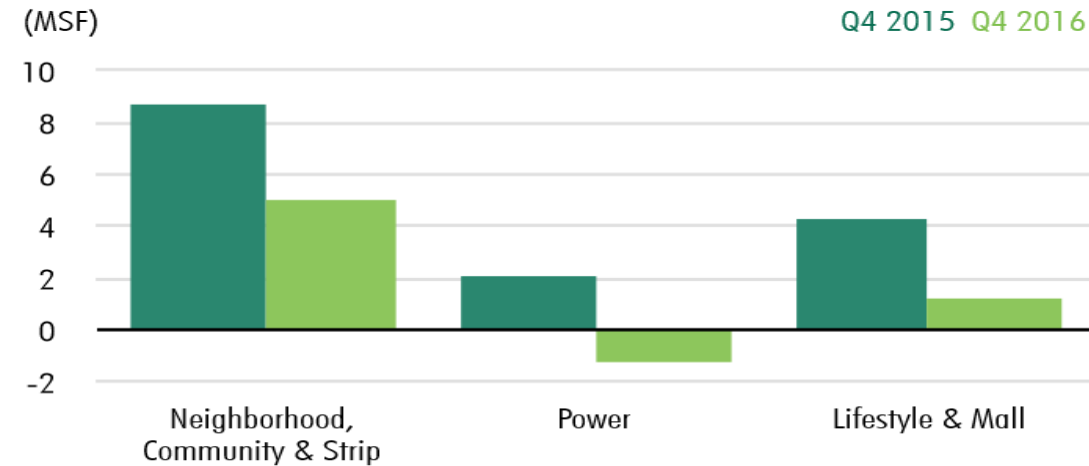
- Department stores lose ground
- Food/drinking services: NY's Eataly
- Small/discount grocery stores heat up; Aldi, Lidl
- Completions remain low, availability at 7.1%
- Rents experience solid growth, \$16.6 PSF

Total Retail Net Absorption



Source: CBRE Econometric Advisors, Q4 2016.

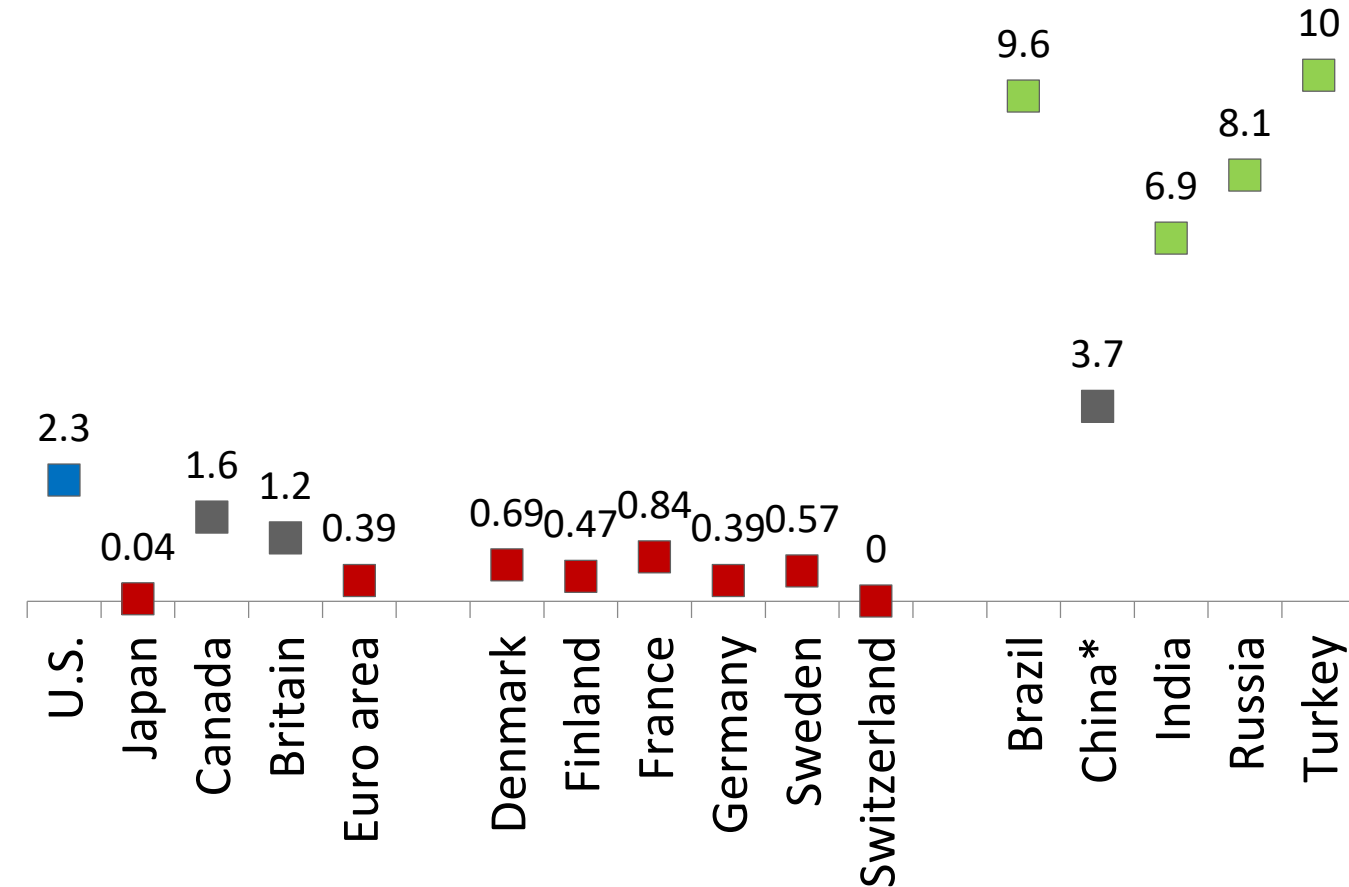
Net Absorption by Center Type



Source: CBRE Econometric Advisors, Q4 2016.

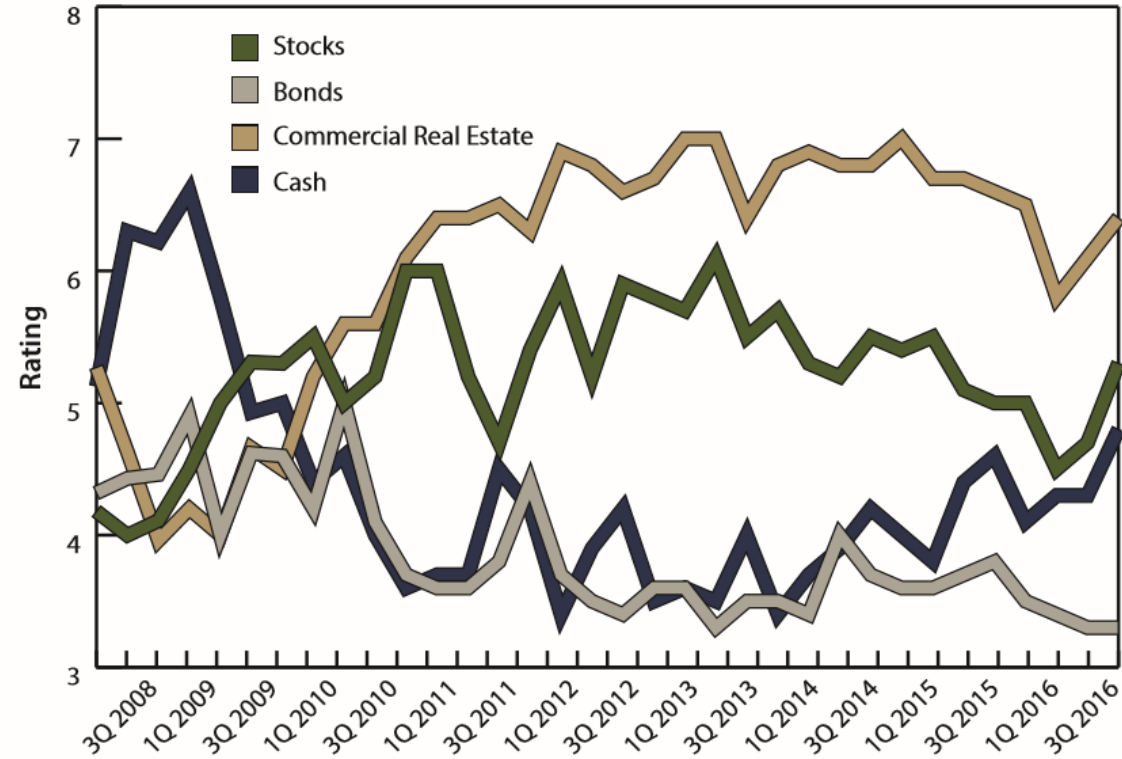
Speaking of investors...

Interest Rates % (10-yr Gov bonds)



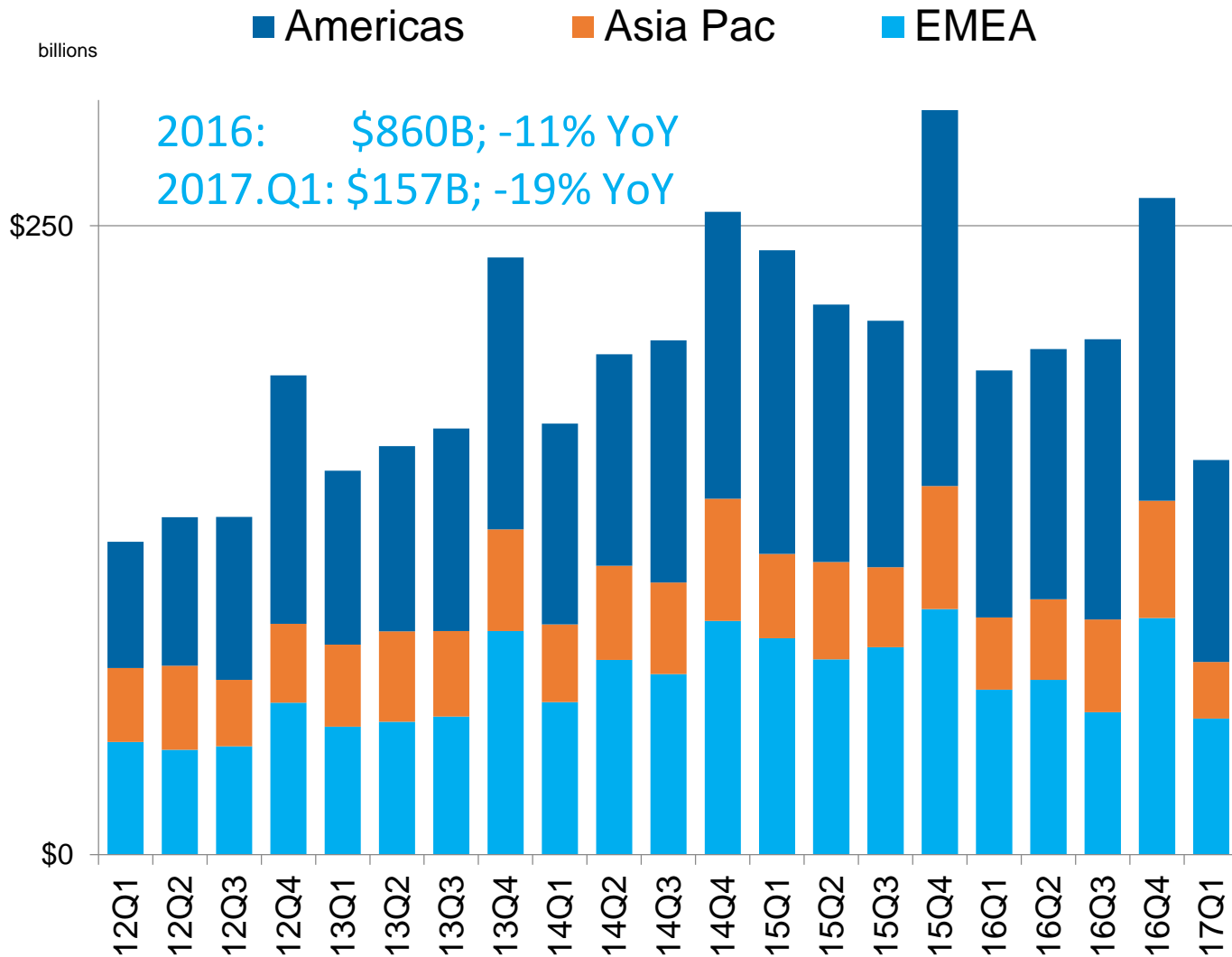
Source: Economist Intelligence Unit; *5-year yield

Situs RERC Historical Ratings of Investment Alternatives



Source: Situs RERC, 3Q 2016.

Global CRE investors hit 'Pause' button, search for yield



Source: Real Capital Analytics

16 U.S. Markets in Global Top 30

Market	Sales Vol. (\$B)	YoY % Chg.
NYC Metro	\$60.0	-25%
LA Metro	\$34.9	-5%
SF Metro	\$30.0	-6%
London Metro	\$27.7	-50%
Paris	\$23.1	-19%
DC Metro	\$18.5	-18%
Dallas	\$18.0	2%
Chicago	\$17.5	-12%
Tokyo	\$16.4	-40%
Atlanta	\$15.6	-3%
Miami/So Fla	\$15.1	4%
Shanghai	\$14.8	-1%
Boston Metro	\$13.9	-11%
Seattle	\$13.7	2%
Hong Kong	\$13.5	14%
Amsterdam/Randstad	\$10.7	18%
Denver	\$10.5	26%
Seoul	\$9.9	142%
Phoenix	\$9.6	-9%
Berlin-Brandenburg	\$9.6	-28%
Sydney	\$9.3	-19%
Austin	\$8.3	12%
Singapore	\$8.1	39%
Houston	\$8.0	-28%
Rhine-Ruhr	\$7.9	-18%
Madrid	\$7.5	20%
San Diego	\$7.2	-15%
Las Vegas	\$7.2	117%
Munich	\$6.7	5%
Frankfurt/Rhine-Main	\$6.7	-11%

Where is global CRE money flowing (large cap)?

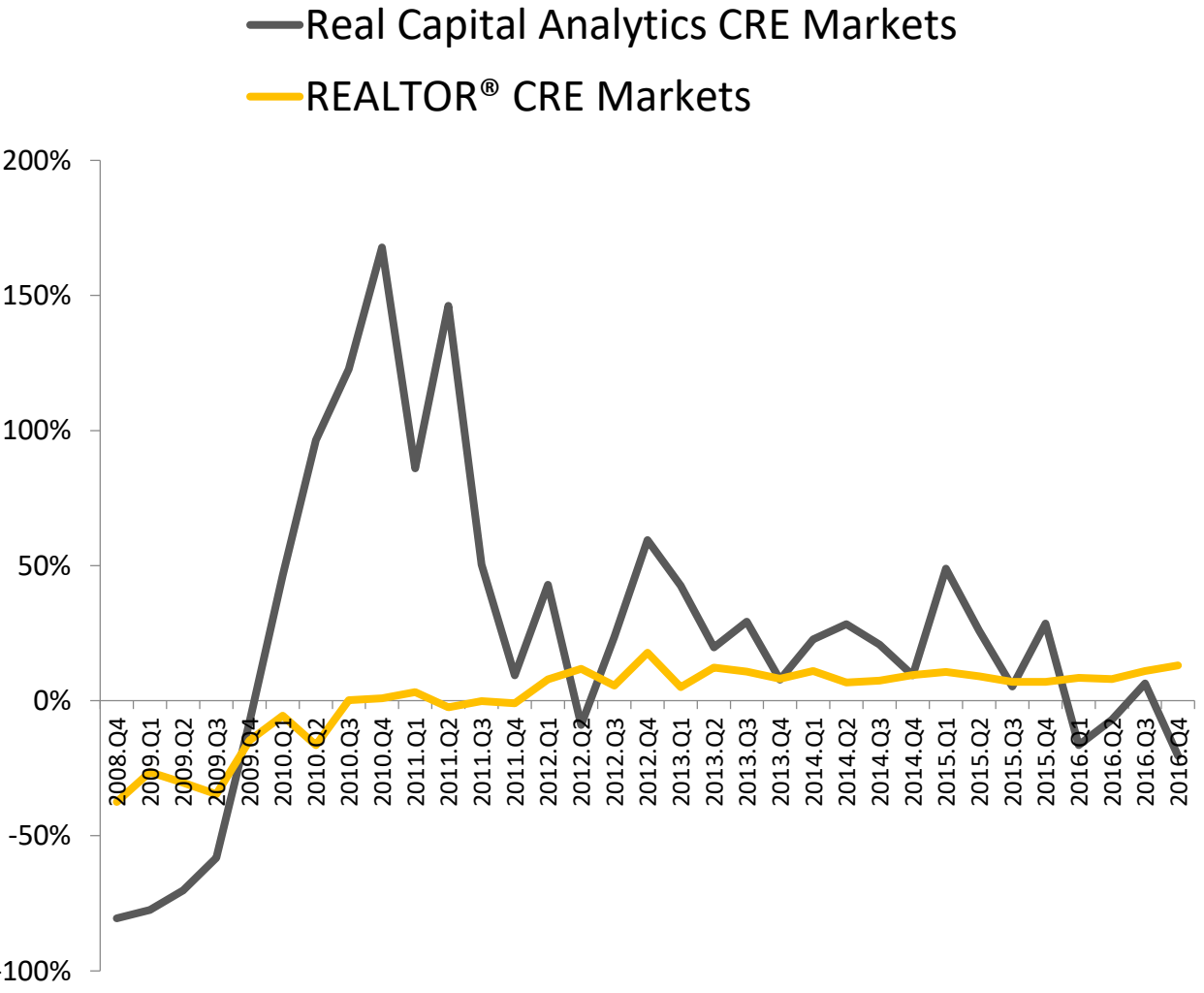
	Q1'17		Last 12 Months	
	\$b	YOY Chg	\$b	YOY Chg
United States	76.1	-19%	387.8	-8%
Germany	17.1	40%	68.5	-4%
United Kingdom	10.4	-47%	53.1	-45%
China	4.2	-40%	35.0	-2%
Japan	7.2	-13%	31.3	-19%
France	3.9	-37%	30.5	-12%
Australia	1.8	-59%	23.8	-26%
Canada	3.2	-19%	18.5	1%
Spain	3.5	63%	17.9	76%
Sweden	2.9	-24%	17.3	12%
Netherlands	2.1	-29%	14.7	7%
South Korea	2.0	242%	14.0	30%
Hong Kong	2.9	-41%	13.2	-10%
Italy	1.7	-40%	10.1	-4%
Singapore	2.3	170%	10.0	107%
<i>All Others</i>	<i>15.1</i>	<i>-23%</i>	<i>78.1</i>	<i>-13%</i>
Grand Total	156.8	-19%	823.9	-10%

YoY Sales Volume Gains - Q1.2017

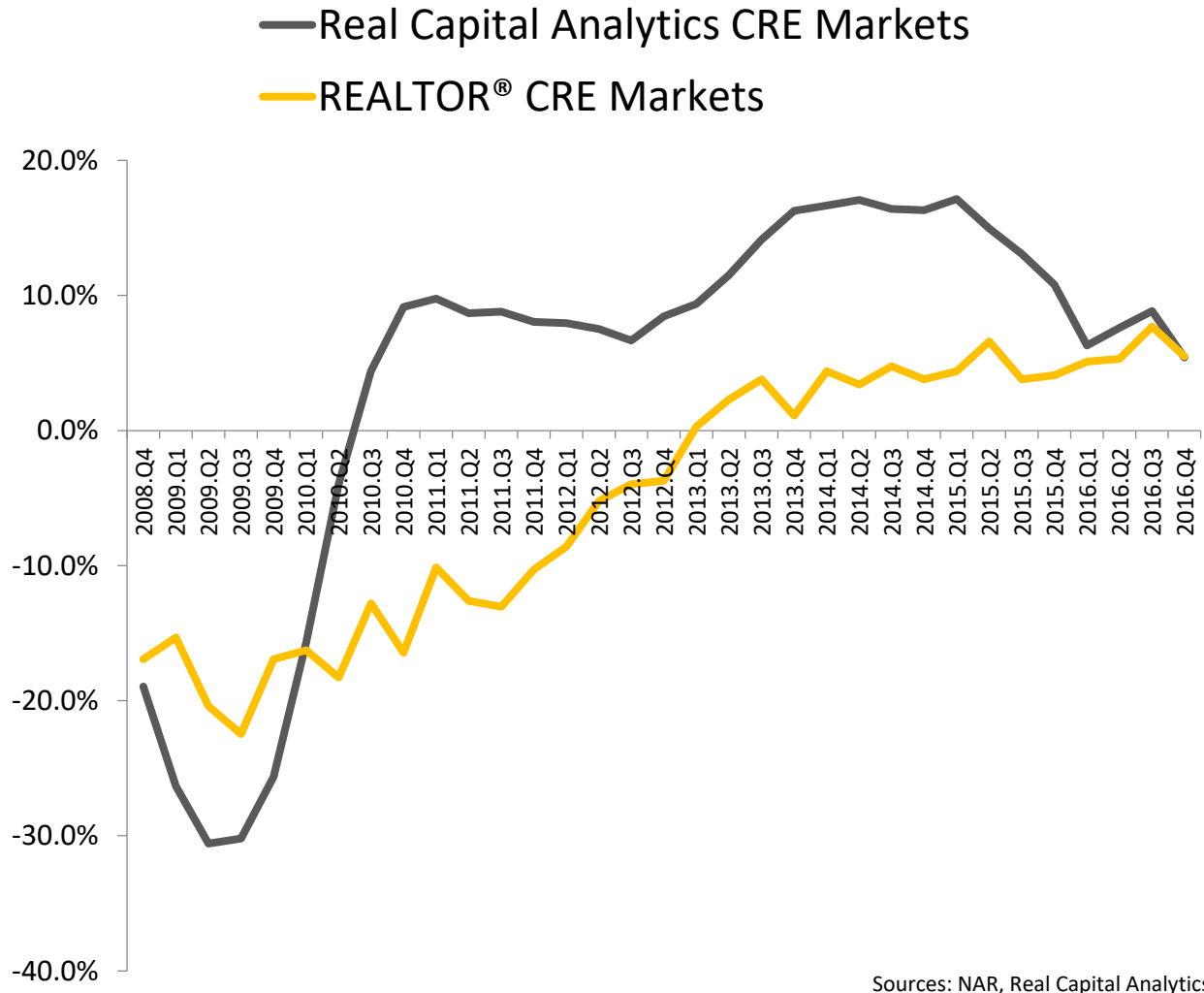
- San Francisco: 15%
- Dallas: 11%
- Charlotte: 45%
- Houston: 10%
- Baltimore: 97%

U.S. CRE is a tale of two markets...

Sales Volume (YoY % Chg)

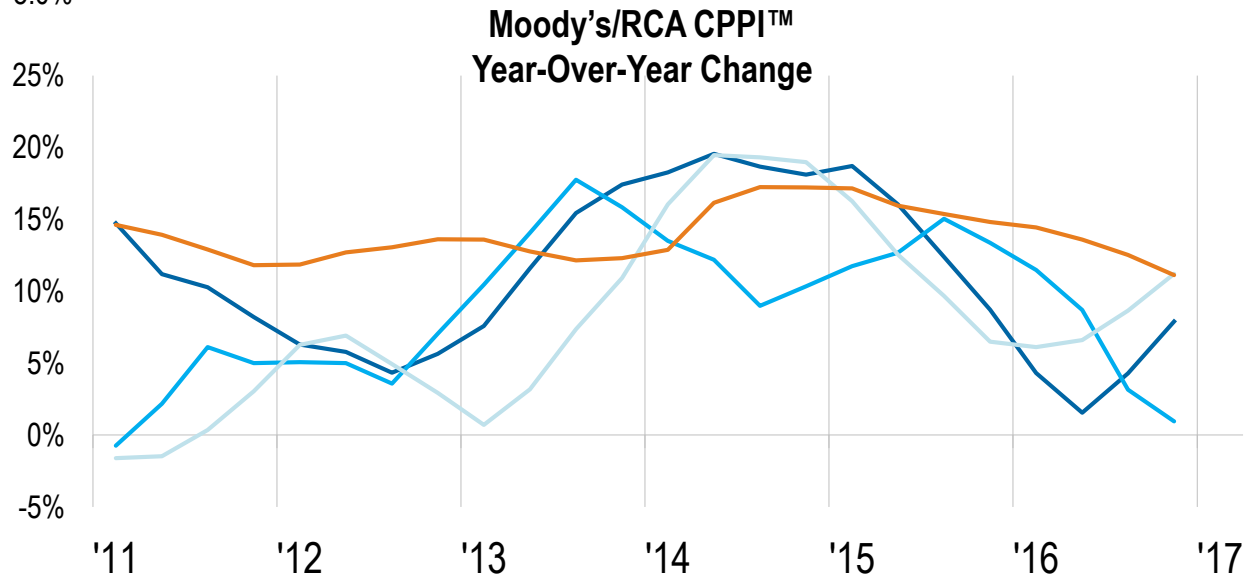
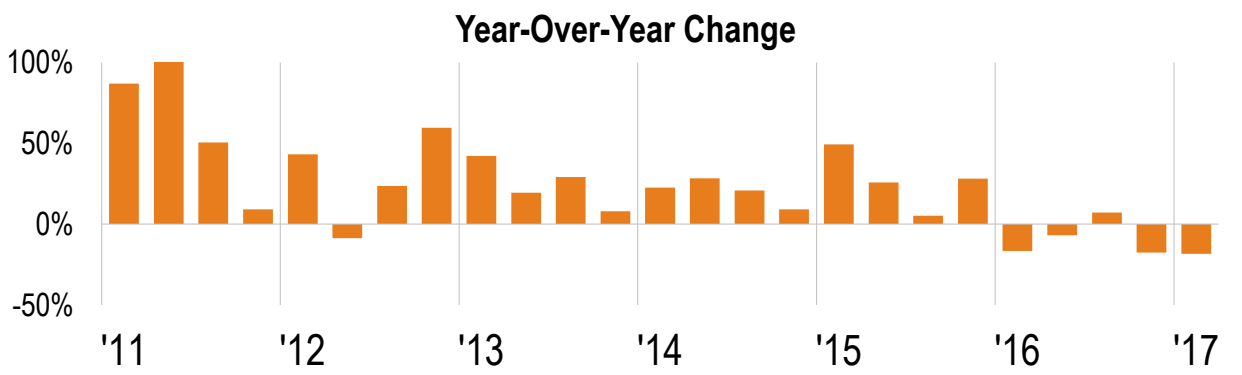
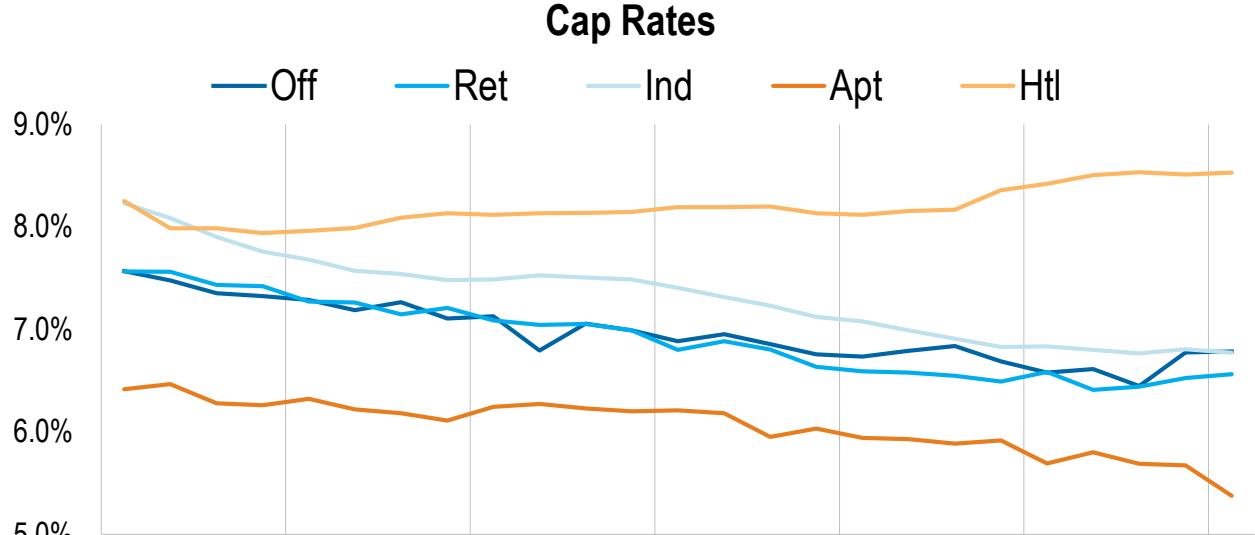
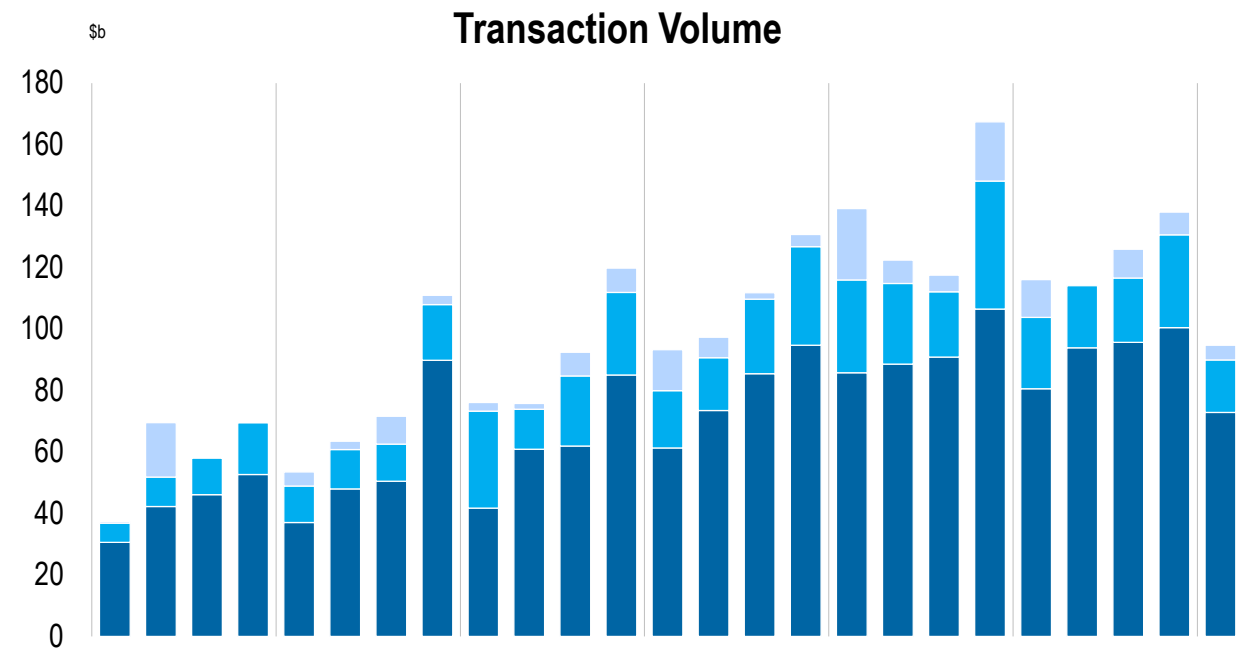


Sale Prices (YoY % Chg)



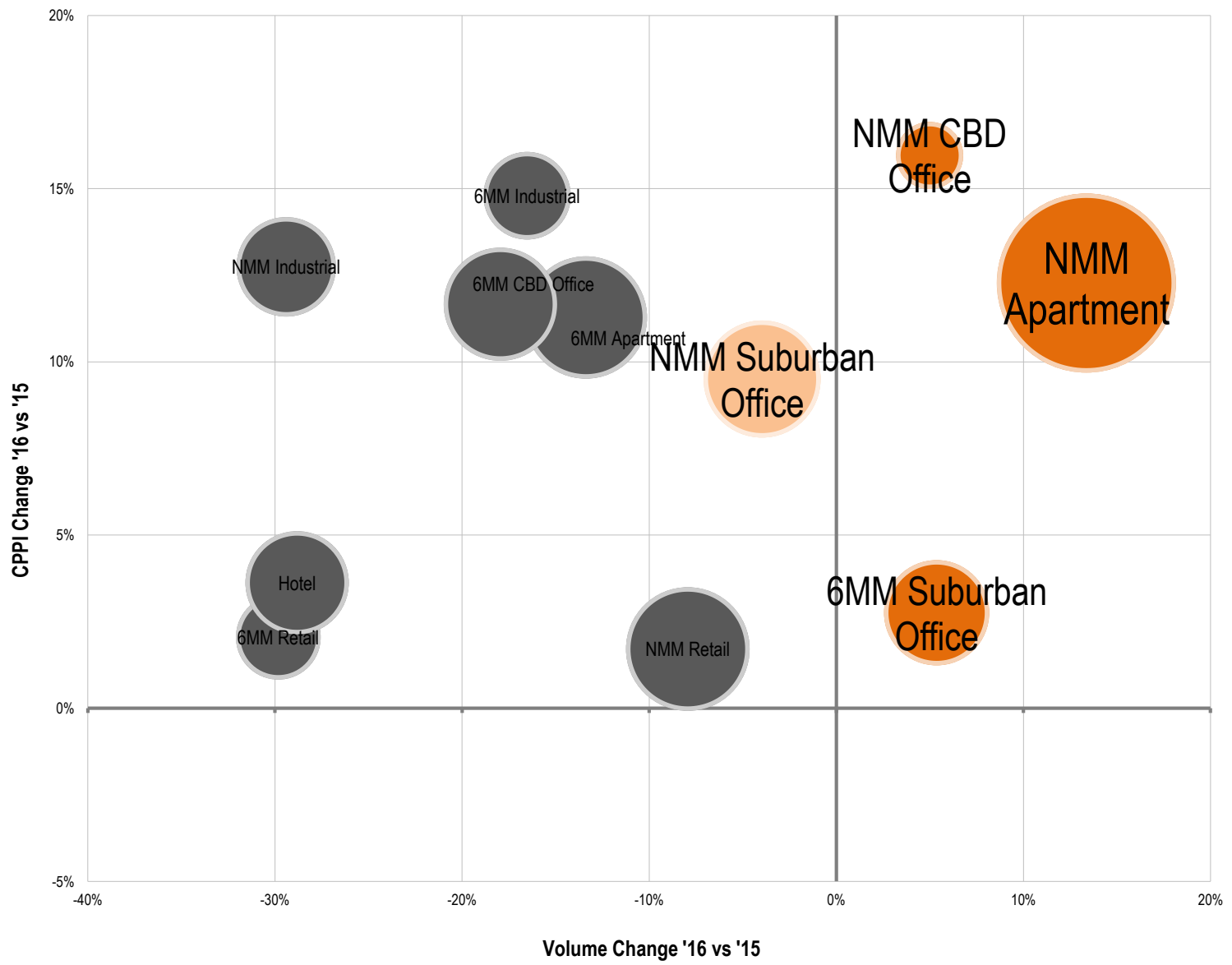
Sources: NAR, Real Capital Analytics

Large cap U.S. markets follow global trends...



Source: Real Capital Analytics

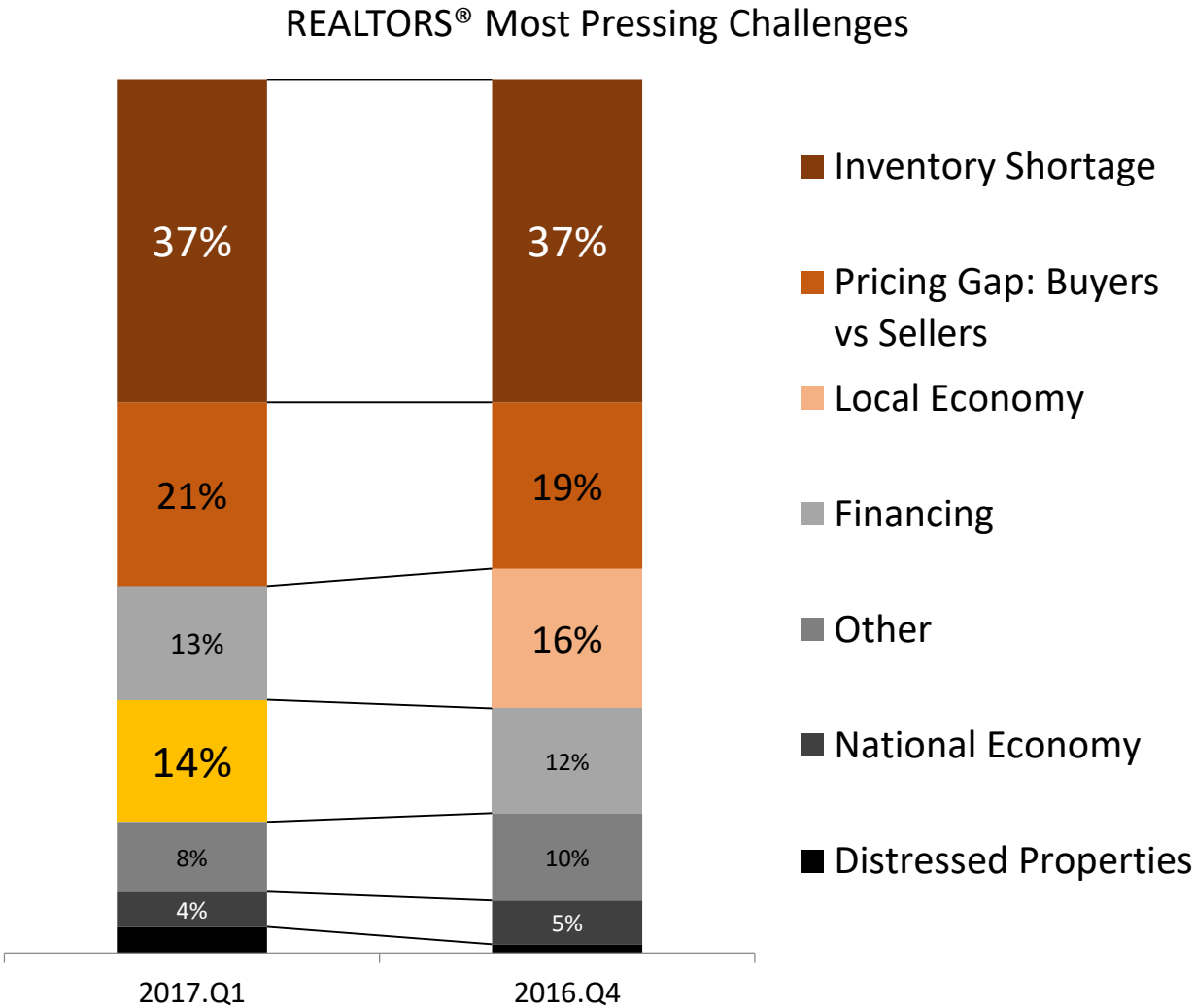
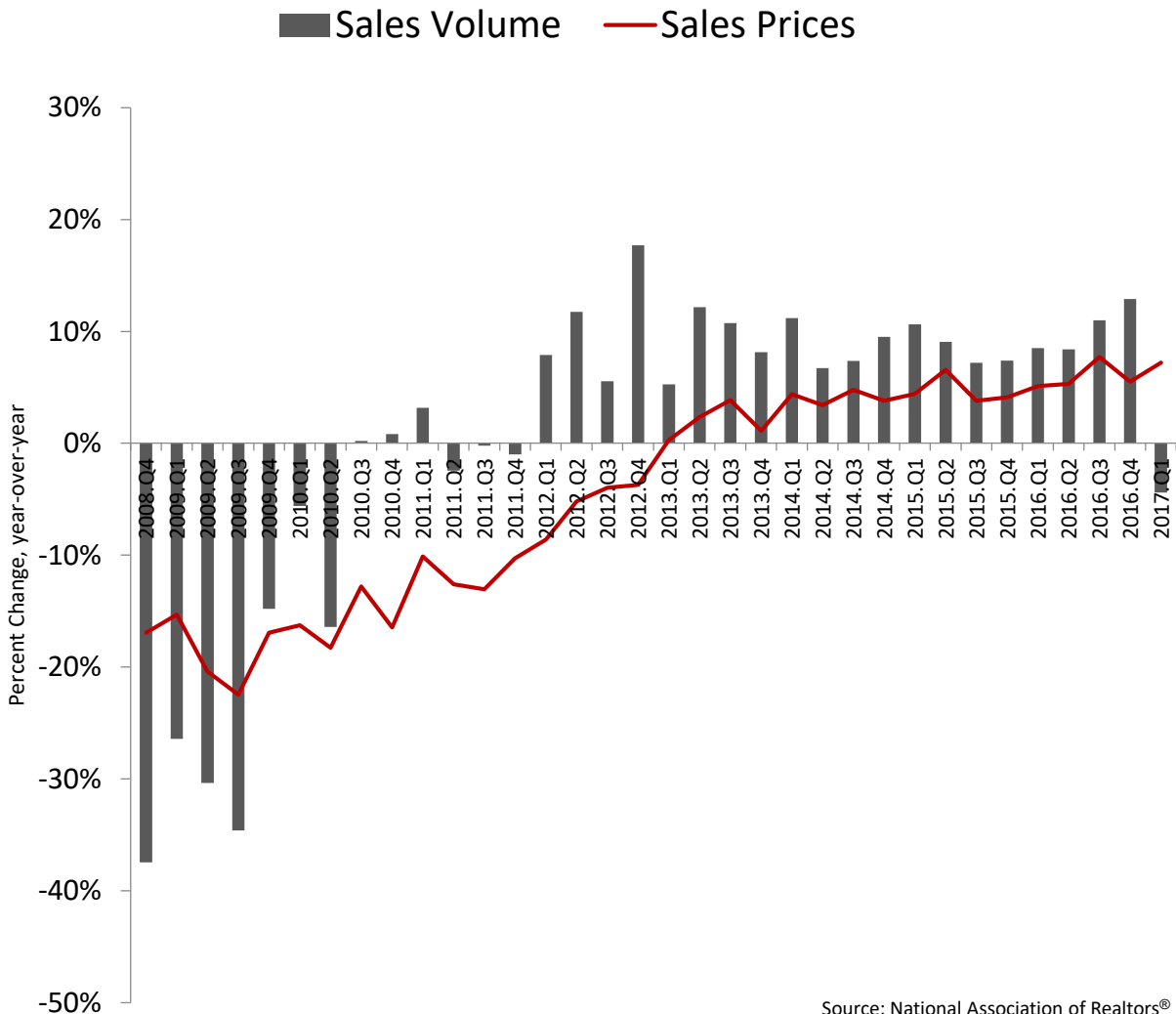
...as yield drives gains in secondary CRE markets



	2016	
	Vol (\$b)	YOY
Office	141.7	-6%
Retail	75.7	-16%
Industrial	59.2	-24%
Hotel	35.8	-29%
Apartment	158.4	3%
Dev Site	17.8	-26%
Total	488.6	-11%
Major Metros	206.1	-16%
Secondary Markets	215.5	-3%
Tertiary Markets	64.5	-12%

Source: Real Capital Analytics

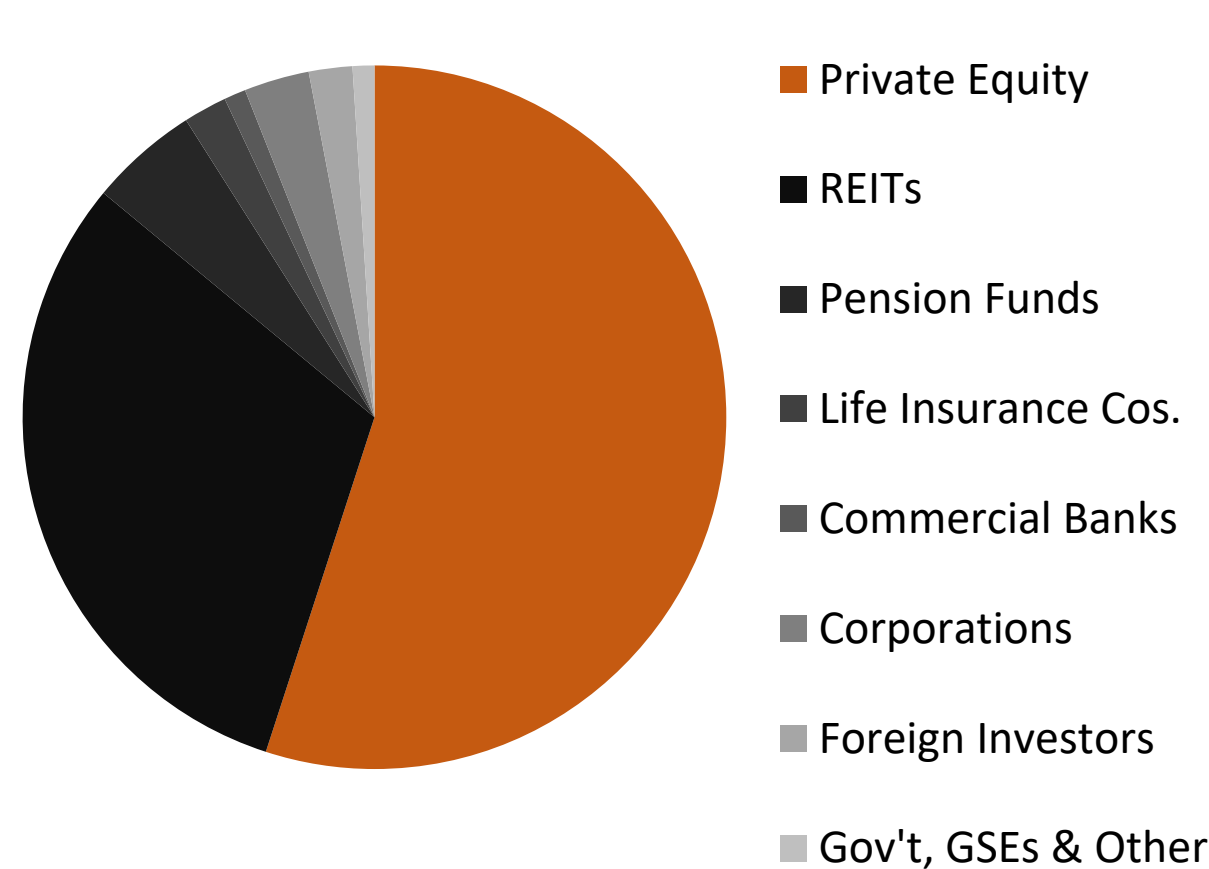
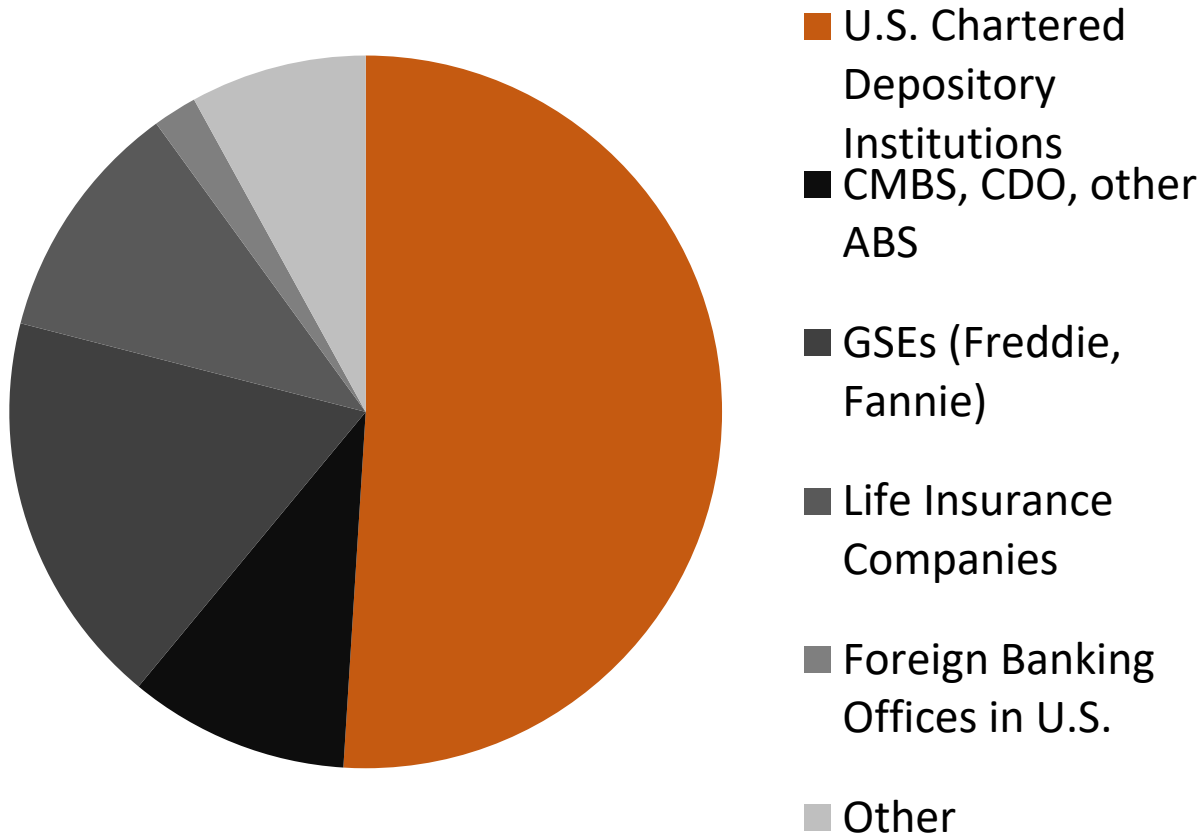
REALTORS® sales drop 4.4% in Q1.2017. Blip or trend?



Capital markets retain liquidity at high end...

CRE Debt Universe - \$3.76T

CRE Equity Investments - \$2.85T

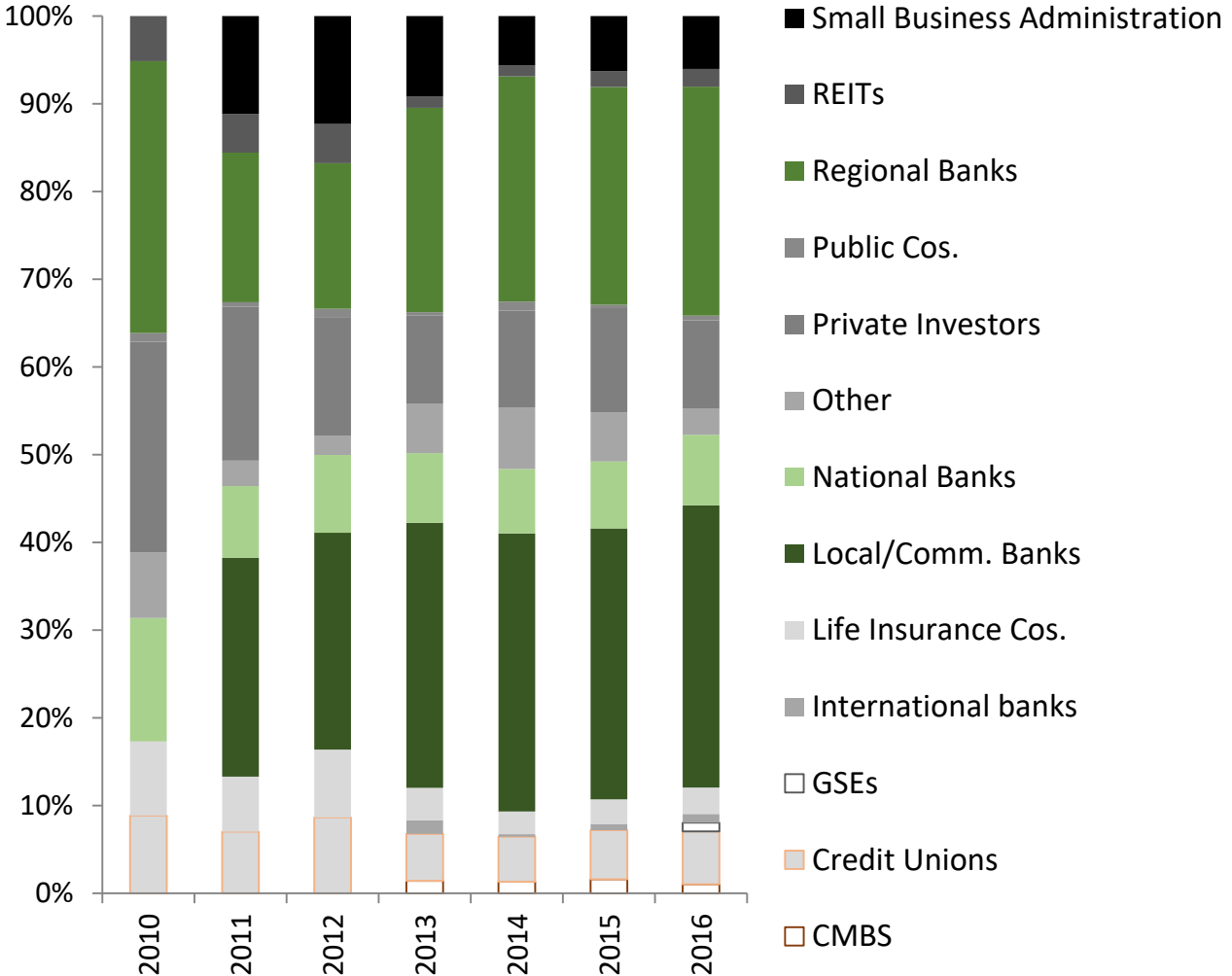


Source: Federal Reserve Board

Sources: Situs RERC, NAREIT, PREA, AFIRE, Prequin, Real Capital Analytics, NCREIF

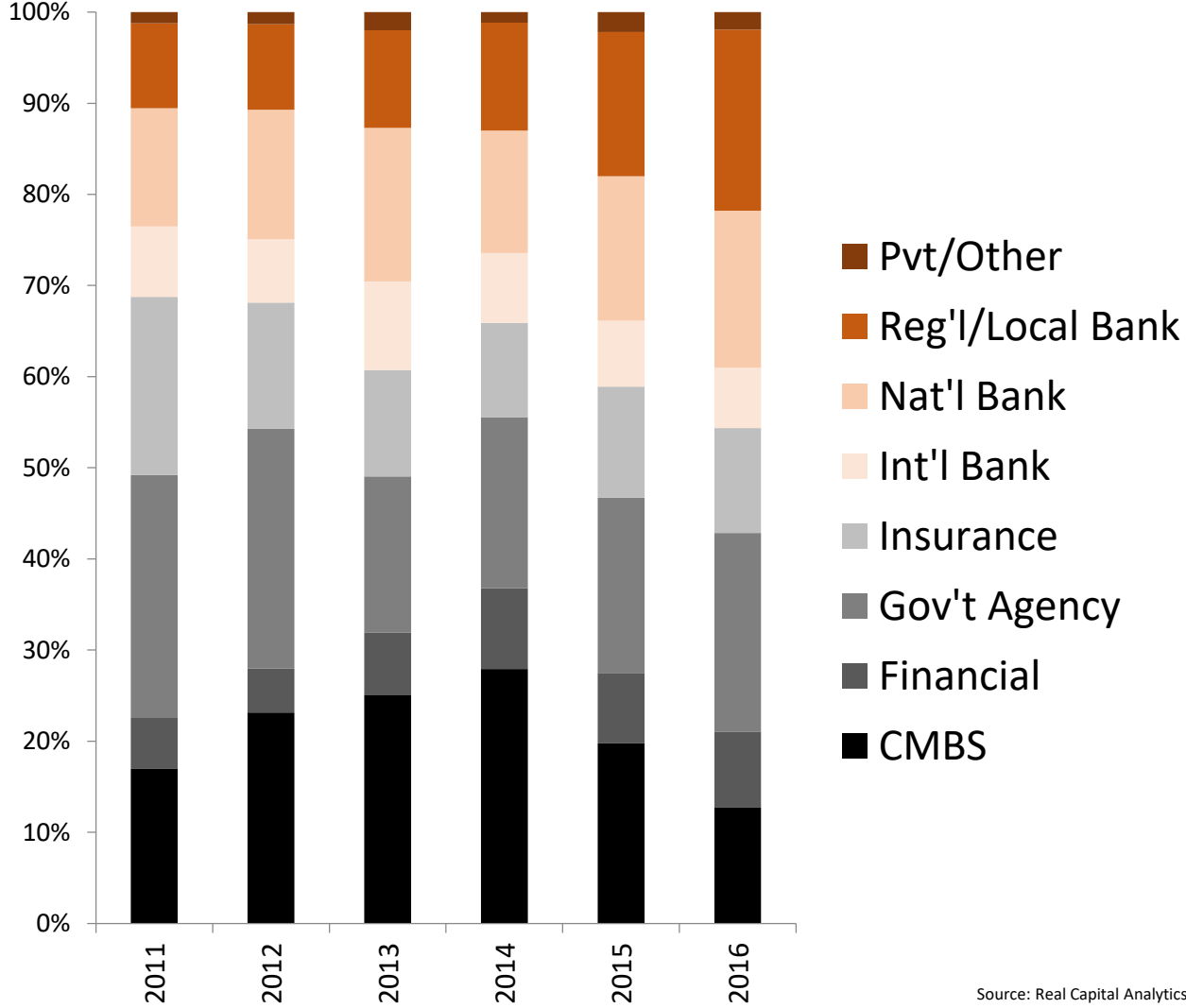
...as financing in small cap markets diverges...

REALTOR® Commercial Real Estate Lending Sources



Source: National Association of REALTORS®

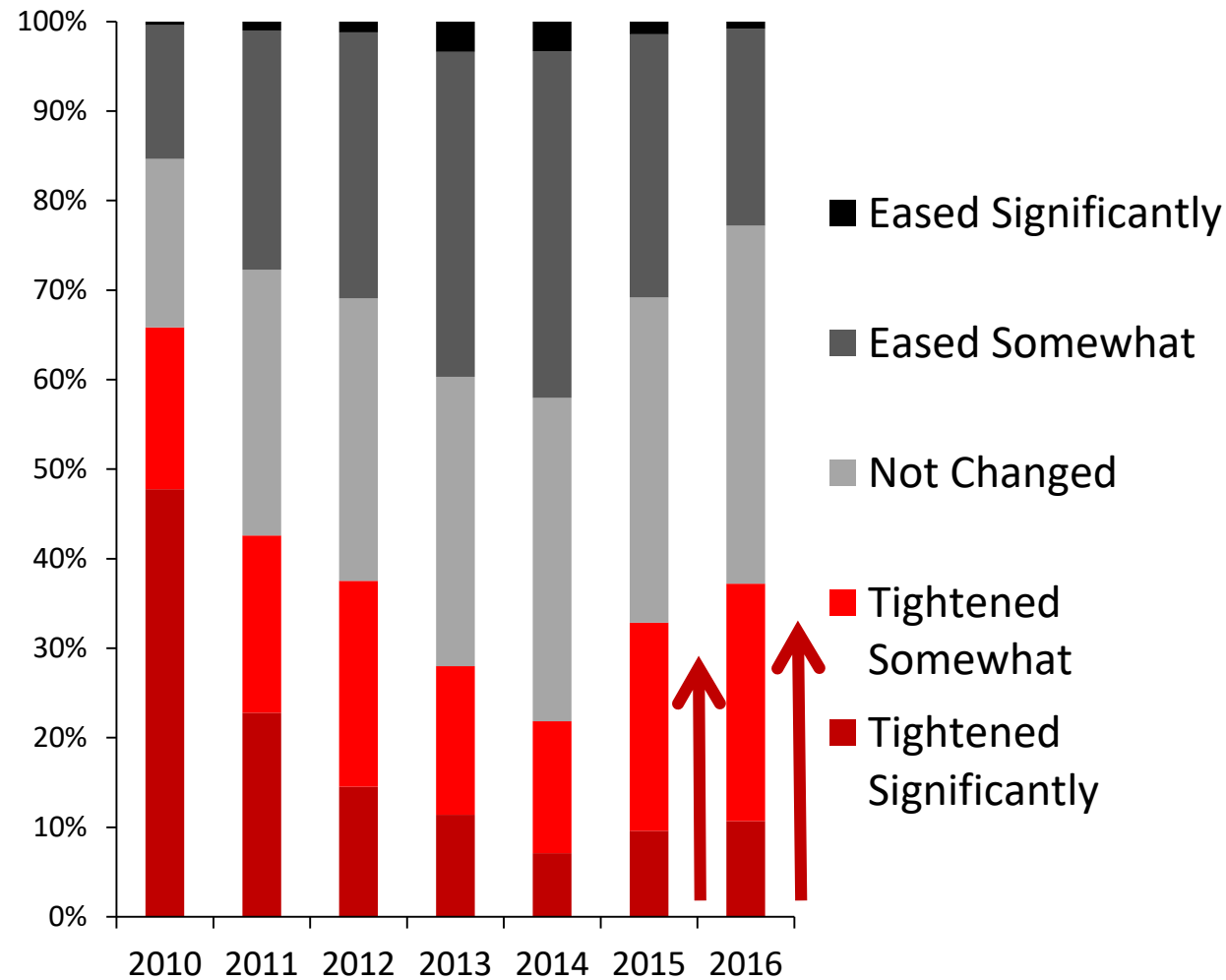
Real Capital Analytics Lending Sources (\$2.5M+)



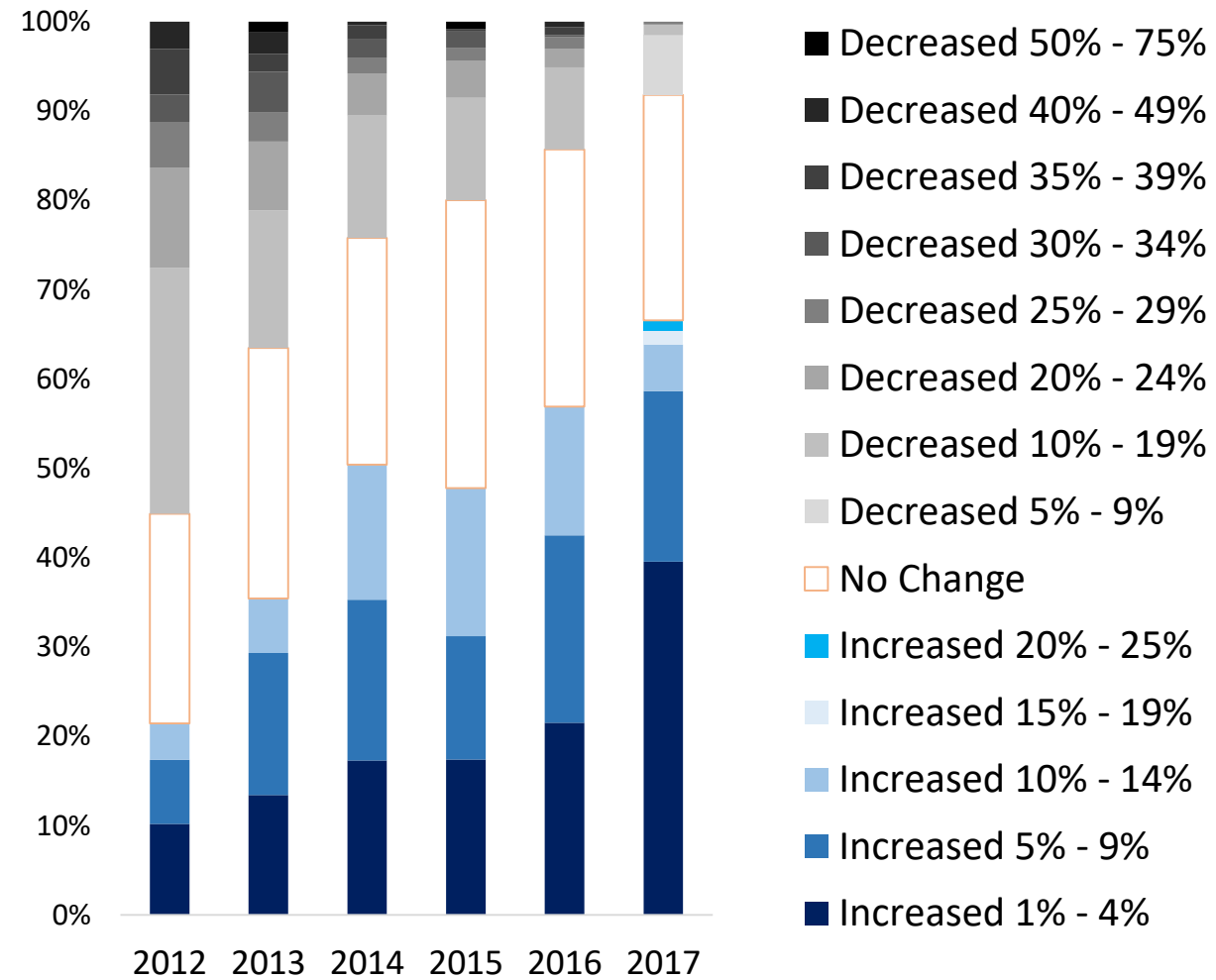
Source: Real Capital Analytics

...and lending conditions tighten, despite rising NOI

Change in Lending Conditions over Past Year



12-Month Change in NOI (\$/SF) of properties sold/leased

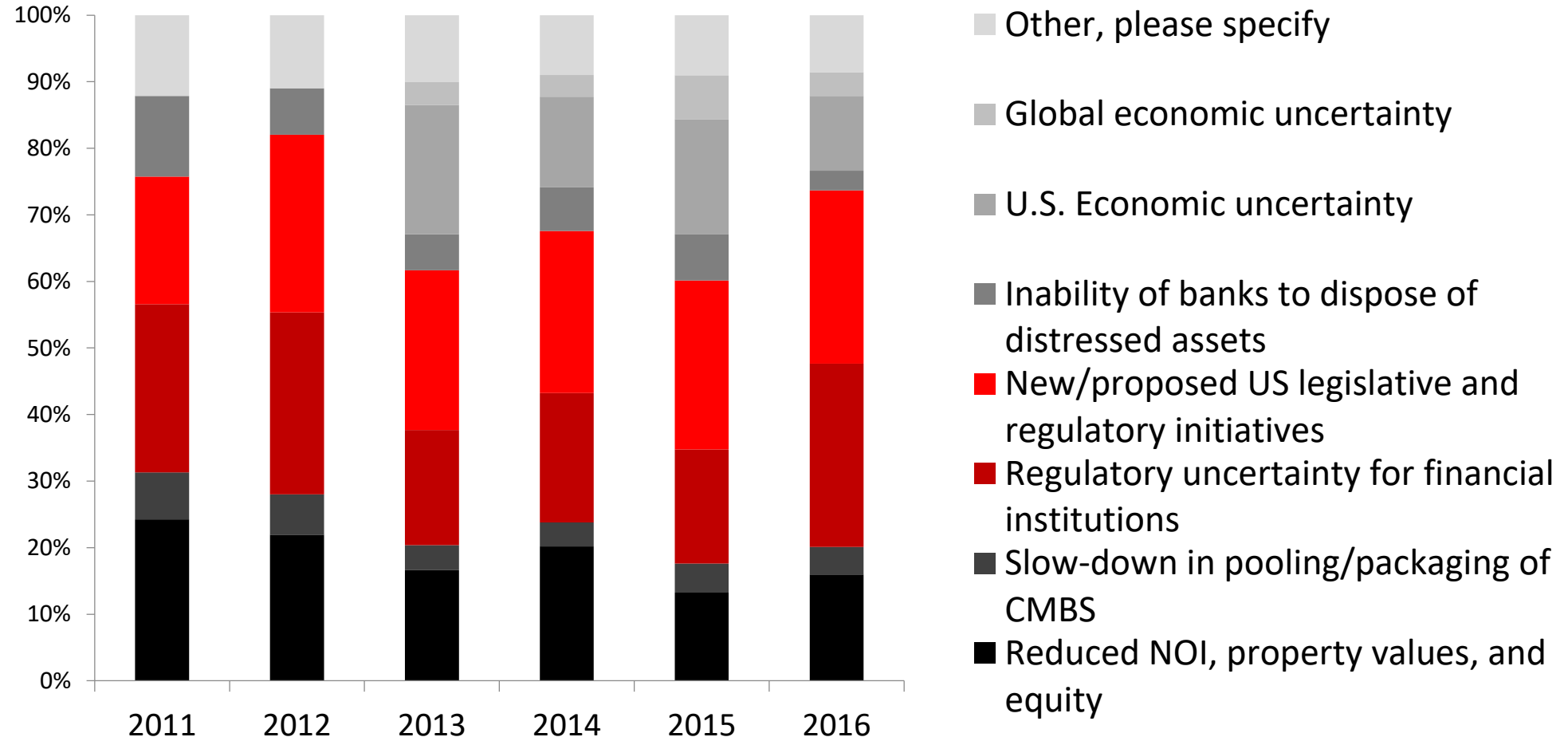


Source: National Association of REALTORS®

Source: National Association of REALTORS®

Legislative & regulatory uncertainties remain

Causes of Insufficient Bank Capital for CRE Lending:



CRE Outlook – positive fundamentals for 2017



Commercial Real Estate Vacancy Forecast (%)

	2016.Q4	2017.Q1	2017.Q2	2017.Q3	2017.Q4	2018.Q1	2018.Q2	2018.Q3	2016	2017	2018
Office	13.6	13.5	13.3	13.0	12.7	12.5	12.4	12.4	13.0	13.3	12.5
Industrial	9.4	9.2	9.0	8.7	8.4	8.1	7.9	7.9	9.4	9.1	8.1
Retail	13.2	12.5	12.5	12.5	12.6	12.7	12.8	13.1	12.0	12.6	12.8
Multifamily	5.9	6.5	6.3	6.1	6.5	6.2	6.1	6.2	6.3	6.2	6.2

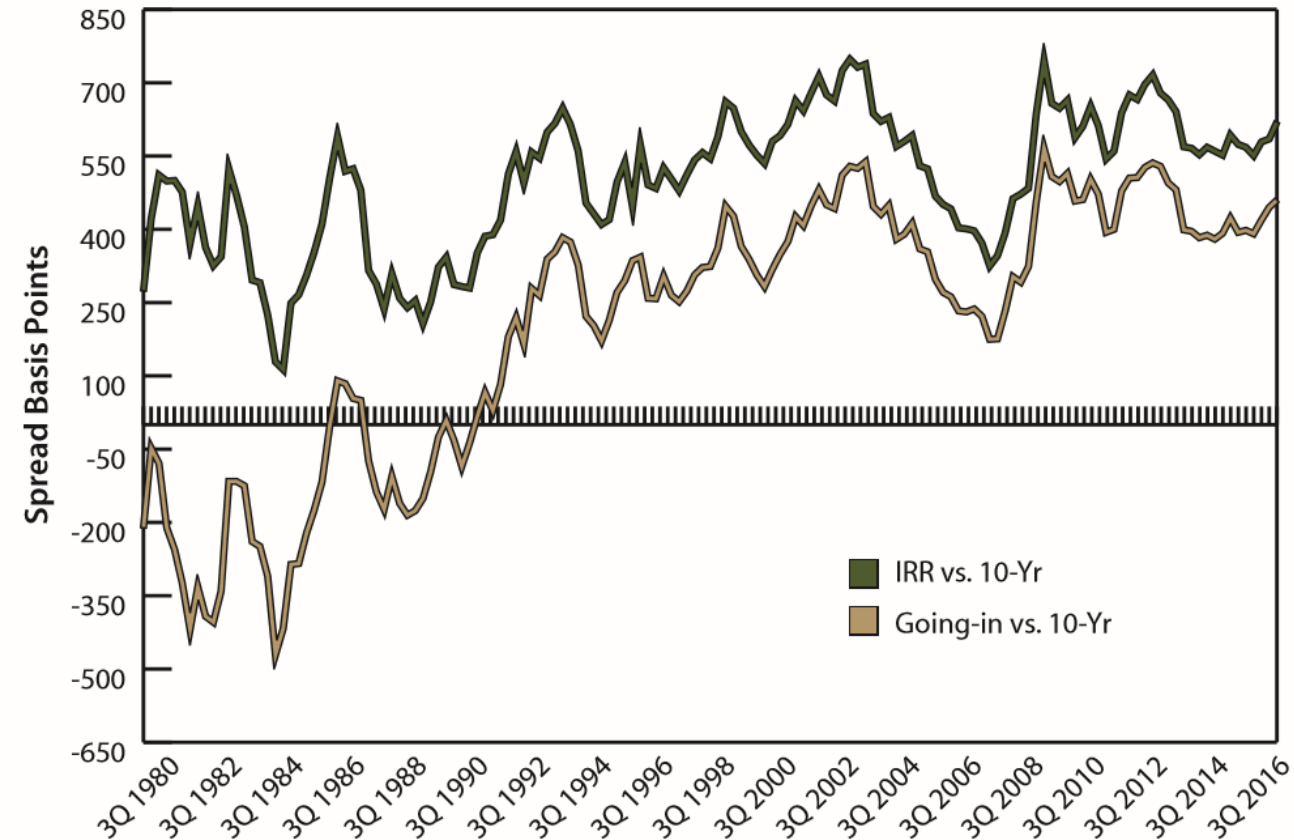
CRE Outlook – investment risks

Risks

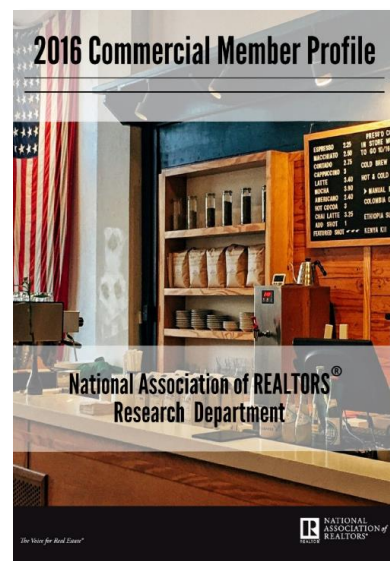
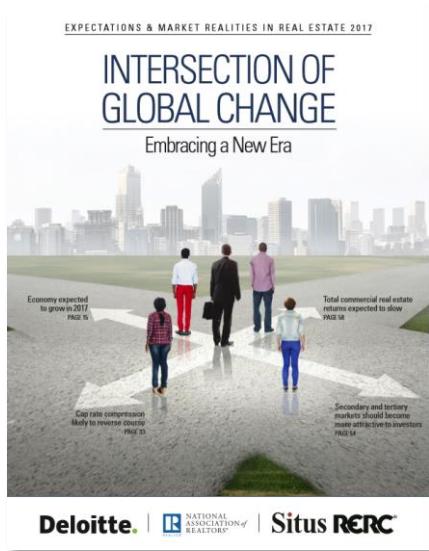
- Economic growth > CRE Fundamentals
- Cost of funds vs. yield

- Legislative:
 - Tax reform
 - IRC Sec. 1031
- Regulatory:
 - Dodd-Frank (?)
 - Basel III - HVCRE

Spread Between CRE Yields or Going-in Cap Rates and 10-Year Treasury



Sources: Situs RERC, Federal Reserve, 3Q 2016.



- Economy
- Capital markets
- Property markets
 - Office
 - Industrial
 - Retail
 - Apartment



- Economic Overview
- Commercial Real Estate
- Survey Results
 - Market Environment
 - Lending Environment
 - Appraisals

Commercial Real Estate 2017: Changes in the Air

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