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Social, political, and technological changes have become the new reality. Investors are encouraged to begin to align to these new realities or face the possibility of becoming obsolete.

Situs RERC

United States

A Market Report published by International Realty Valuation, Inc.

Investment Barometer

2016 saw a small shift in expectations as the CRE market either retreated in non-core locations, or stayed stable. Overall rates were mostly unchanged in 2016 with some risk premiums in 2017 because of the many unknowns. After the US election the markets applauded, then pulled back and are now in a holding pattern. Whether stock or real estate, the investors want transparency and predictability. While 2016 may have been seen with rose-colored glasses, 2017 is seen through a

microscope noting the flaws, cracks and junctures. Interest rates were on hold in 2016 which allowed predictability. 2017 has interest rates rising – this is the year of wear and tear, and some uncertainty. Cap rates are bumping up 10 to 20 basis points and investors should be prepared to hold long term, or immediately evaluate their positions.

When cap rates are believed to be a good deal at 5% or less, they are not. Rents will not increase that much.

2016 was mostly the time to lock in gains. If you did not, there are still opportunities in 2017 – sector by sector and location by location. Caveat – do your homework. The good news is that the United States is the preferred investment location for nearly all property types. Even with small increases in interest rates and stubborn restrictions on lending, the best US real estate markets are: **Austin, Dallas, Portland, Seattle, Los Angeles, Nashville, Raleigh, Orange County, Charlotte and San Francisco.**

By the Numbers

According to **Costar National Market Reports:**

Office – Cap Rates

2016: 5.7% | 2017: 5.8%

Top markets in net absorption as a percentage of inventory: *Austin, Seattle, Raleigh, Salt Lake City and Provo.*

The national office vacancy rate was 9.7% with an average all class annual rent of \$30.71 psf which was a 0.5% increase from 2016.

Retail – Cap Rates

2016: 5.6% | 2017: 5.8%

Top markets in net absorption as a percentage of inventory: *Dallas, Phoenix, Charlotte, Las Vegas, and Austin.*

The national retail vacancy rate was 4.8% with an average annual rent of \$16.00 psf which was a 3.31% increase from 2016.

Industrial – Cap Rates

2016: 7.2% | 2017: 7.3%

Top markets in net absorption as a percentage of inventory: *Inland Empire, Phoenix, Atlanta, Charlotte and Salt Lake City.*

The national industrial vacancy rate was 5.3% with an average annual rent of \$6.14 psf which was a 1.7% increase from 2016.

Apartment – Cap Rates

2016: 5.0% | 2017: 5.1%

Top markets in net absorption as a percentage of inventory: *Denver, Austin, Charlotte, Orlando and Dallas.*

The national apartment vacancy rate was 5.8% with an average annual rent of \$1,354 per unit which was a 2.0% increase from 2016.



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What's Next – Who Knows – Watch Out

By Lance W. Doré, FRICS, MAI

There are several “event horizons” in play that may or may not be the soothsayers of what’s next.

The first predictor will be the impact on CRE when interest rates increase more than 100 basis points in any 12 months. There is simply too much real estate that will need to be refinanced and if rents have not increased many investments may again be underwater. Caveat – The financial crisis from 2008 to 2012 showed loans originated and backed by ten-year loans that peaked in 2006 and 2007. They are now coming due.

The second predictor will be political. If the current administration can provide assurances and direction in Wall Street, the markets will respond favorably. But if the current administration falters the markets will come under significant distress and the default is the safe haven – cash. Real Estate is not a liquid asset.

The third predictor will be if consumer spending will be on the retreat. Consumers have been adding to household debt. This may finally be heavy enough that the consumer slows the spending and the economic engine will grind down, slowly. Watch for declines in car, household appliances and discretionary travel.

Watch for changes in employment trends.

Unlike the last severe recession, the likelihood of a precipitous fall is very unlikely, but rather the next recession will be an adjustment and more focused on a few sectors and geographies.

Who knows? Well – Wall Street knows. There are signs that a gradual divestment of risk is underway with the selling of soft real estate assets. Soft real estate is that real estate that is not core. It is a way to not spook the markets.

Who’s selling? The top apartment deals - JP Morgan, Trammel Crow, and Hines Global REIT.

The top office deals – Morgan Stanley Real Estate, Piedmont Office Realty Trust, Met Life, and RXR Realty.

The top retail deals – Macy’s, PGIM Real Estate, Provident Real Estate Ventures, and IM property Investments.

The top industrial deals – Black Rock, Levin Properties Inc, CIM Group, and BYTEGRID Holdings.

These are smart players and they are starting to take profits.

The key to watch out for in 2017 going into 2018 is – Flex Real Estate.

Demographic pressures and technology advances are colliding.

The collision will require real estate to adapt. It is almost an oxymoron where real estate is a fixed asset, but these *sticks and stones* need to be a nimble as an Olympic gymnast.

Millennials require urban housing and access to all forms of technology. To meet this demand urban shopping centers are converting to residential, shared office and social centers where they can *plug in*. Baby boomers want services, similar to millennials, but now the shopping centers are converted to gyms, day spa salons and health care centers.

New construction for housing must adapt and allow conversion from “for rent”, to “for sale” with quality and floorplans that can accommodate Airbnb flexibility and multi-generational living.

Office space must allow for traditional privacy, but with open floor areas for social interaction at the coffee bar. Tenants must connect both in and out of the office, 24 hours a day.

Industrial must adopt old-world national transportation platforms with new world technology for *Amazonish* distribution.

The long game in real estate must remember its roots and use the short game to diversify and stay in the game.

“To keep CRE prices afloat, NOI growth needs to accelerate to overcome dual headwinds of rising rates and tighter lending standard. However, the reality is that it is decelerating, which is different than prior rate hike cycles. We therefore believe valuations can decline even without a recession, which was a necessary condition for the past two declines in CRE prices in the early 1990s and 2008.”

—Morgan Stanley





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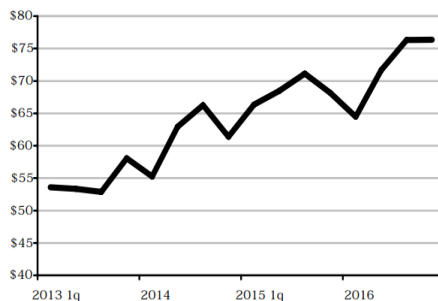


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Historical Price/SF Average

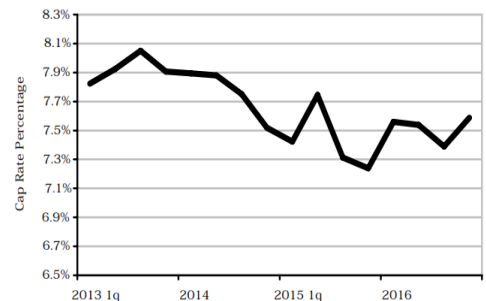
Based on Industrial Building Sales of 15,000 SF and Larger



Source: CoStar COMPS®

Historical Cap Rate Average

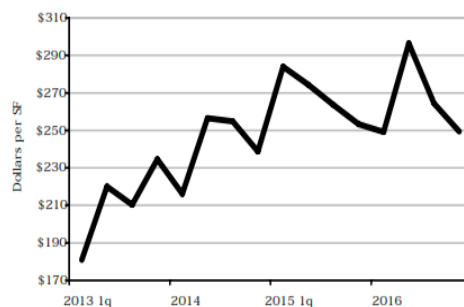
Based on Industrial Building Sales of 15,000 SF and Larger



Source: CoStar COMPS®

Historical Price/SF Average

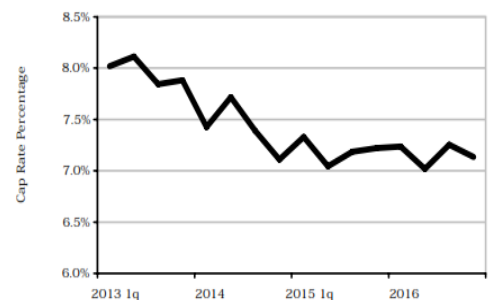
Based on Office Building Sales of 15,000 SF and Larger



Source: CoStar COMPS®

Historical Cap Rate Average

Based on Office Building Sales of 15,000 SF and Larger



Source: CoStar COMPS®

About the Author



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As a Founding Partner and President of International Realty Valuation, Inc., Lance values a wide variety of conventional and complex properties, serves as litigation support to public and private clients, and provides expert advisory services. His geographical expertise is focused in the western U.S., and his professional expertise is focused in energy facilities, conservation land, open space corridors and ranches.

About IRV, Inc.

International Realty Valuation, Inc. (IRV) is a global network of independent and highly competent professionals committed to providing expert financial reporting, forensics, consultation, and valuation services for both tangible and intangible assets to the most discerning of public and private clients. With a number of affiliate firms in several countries, our team has cumulative cutting edge knowledge of global and regional markets, as well as international standards and requirements. This enables us to complete a wide variety of assignment, including valuation of large portfolios with multiple locations, in a thorough, objective, timely, and cost effective manner. We serve major national, regional and international banks, lenders, developers, investors, governmental agencies, public and private companies.