2Q 2018
U.S. Market Report, Issue 6

Market Report

International Realty Valuation, Inc.

United States

A Market Report published by International Realty Valuation, Inc.

In this Report:

RE market participants tend to overvalue in-place performance and overestimate the risk of transitional properties

Current CRE valuations and the market cycle favor a defensive position and a move up the capital stack.

Amherst Capital Market

Investment Barometer

2016/2017 was the peak of the market and those investors that purchased will see their single or multiple property portfolio soften in the near future.

2018 will further test the market as lending standards increase, interest rates increase, and property values remain static. In some sectors such as retail, softening occurred in early 2017 and retail is now past softening and is fundamentally in decline.

2018 is the year where the *devil is in the details*. It's time to scrutinize leases, loan commitments, and be realistic about *built in a*ssumptions for rent growth. Start building in static rents, static cap rates and raise your reserve expenses to adjust to market fluctuations at a moment's notice.

The focus in 2014 to 2017 has been the fundamentals of the real estate (location, tenancy, and quality improvements). Real estate is a tangible asset. In 2018 mange your tangible asset with intangible experts (management, marketing, and employees). Maintaining position in a softening market will no longer be dependent on the tangible asset, but rather how your relationships are maintained with those responsible for your asset.

Balancing some disruption due to rising interest rates, ,the economy has strong fundamentals due to low unemployment, strong consumer confidence and tax reforms.

Best markets for the long term: *Seattle, Austin, Salt Lake City, Raleigh//Durham, and Dallas/Fort Worth.*

By the Numbers

According to **Costar National Market Reports**

Office – Cap Rates

Class A: 5.61% to 6.04%
Class B: 7.06% to 7.26%

Top Sale Markets (Total Price): *Phoenix, Chicago, Atlanta, Seattle, Washington.*

The national office vacancy rate was 9.3% with an average all class annual rent of $25.03 psf which was a 18.50% decrease increase from 2Q 2017.

Retail – Cap Rates

≥250K: 4.44% | ≤249K: 5.8%

Top Sale Markets (Total Price): *Las Vegas, Houston, Long Island, Inland Empire, Cleveland.,*

The national retail vacancy rate was 4.5% with an average annual rent of $16.49 psf which was a 3.06% increase from 2Q 2017.

Industrial – Cap Rates

≥250K: 4.94% | ≤249K: 6.49%

Top Sale Markets (Total Price)*: Chicago, San Diego, Philadelphia, Inland Empire, Hampton Roads.*

The national industrial vacancy rate was 4.8% with an average annual rent of $6.56 psf which was a 6.84% increase from 2Q2017.

Apartment – Cap Rates

Primary: 5.1% | Secondary: 6.0%

Top market by Index: *Seattle, LA, Minneapolis, San Diego, Portland.*

The national apartment vacancy rate was 6.8%. Top Rental growth markets are: *Sacramento, Portland, Seattle, Atlanta and Oakland.*

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Rose-Colored Glasses v. Blockchain

Lance W. Doré, FRICS, MAI

We are in the vortex of multiple asynchronous and synchronous events that impact real estate.

The random events include politics, social demographics technology, historical real estate cycles, consumer debt and interest rates; and whether this will impede on real estate performance (good or bad).

The US politics continues to confound, disrupt and rewrite history. Trumpism is no longer about Republican or Democrat but rather its own unique party brand undefined by the establishment. Both sides of the aisle are scratching their heads and sucking Tums to figure out what the economic tea leaves are reporting. Stay tuned. Impact on Real Estate – Mixed.

Tax cuts have accelerated investment opportunity and corporation still have trillions of cash set aside and are not allocating. This would normally indicate a healthy investment market for real estate. This is countered by an uptick (mostly built into the risk rates) in interest rates which will soften the debt and equity markets appetite for investment. Impact on Real Estate – Slight Upside.

The baby-boomers and millennials are fighting for the same real estate in Hotels, Multi-family, Single Family (Airbnb and VRBO) while Gen X is scrambling for the crumbs. Impact on Real Estate – Upside.

Layered on top of these influencing events is the mostly ever predicable 10-year real estate cycle – which if we look at history puts 2018 squarely in the peak. Other peaks were in 1976, 1988, 1996 (nominal), 2007 and ? Are we riding the precipice and what will precipitate the fall? The stock market which tends to mirror real estate is fluctuating daily as the investment market is trying to assess which way the winds are blowing.

The canary in the mine shaft may be the unspoken level of consumer debt. Consumer credit card debt is just over \$1.0 trillion which is about the same as it was in 2008/2009. However, auto loan debt exceeds credit card debt at \$1.1 trillion. In 2008/2009 auto loan debt was around \$800 billion. But the real time bomb is student loan debt which is \$1.5 trillion. In 2008/2009 student loan debt was around \$700 billion. You can do the math – consumer debt in 2008/2009 was around \$2.5 trillion and in 2018 it is \$3.6 trillion. That is in increase of 44%. Household median income has increased about 5% from 2009 to 2018. Impact on Real Estate – Downward.

Blockchain is the next Financial | Real Estate game changer. Aside from cryptocurrencies (which rely on blockchain technology) the transition has started.

What was the formula for success by capturing information (aka the internet – Google) blockchain will create success by using the information to create value in real estate. A fundamental building block in creating real estate value is transferability of the asset (aka transparency) – blockchain creates efficiency in the process, transparency and therefore value.

Domestically the transition will lumber along, but the big success will be international.

It will start internationally for two reasons: 1) local unstable or unknown currency positions must have a stable platform to protect investors and 2) highly educated and stable technology platform allows new entry without obstacles.

The US market is entrenched in the Old Guard real estate platform with brokerage as the centerpiece like the hub of a wheel. The old model is *Brokerage Bureaucracy* that will do anything to protect its paradigm. The old paradigm is likely to unravel as the spokes of the wheel break.

The intermediaries of real estate that may not be needed are brokerage services, title search, appraisals, insurance, and a minimization of the central role of the mortgage lenders in property transactions.

This will be market and consumer driven as the technology evolves and acceptance gains.

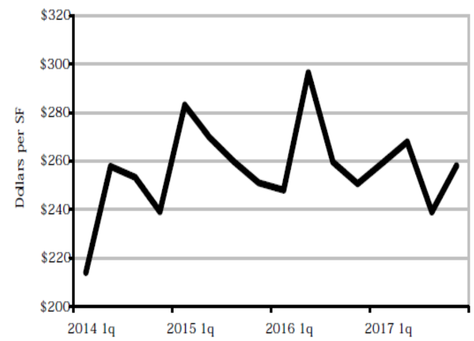
It was not that long ago that internet transactions were suspect, and many said it would never happen – that the consumer would not reveal confidential information, let alone shop over the internet. Tell that to Amazon.

Blockchain will change the playing field in real estate capital flow. Impact on Real Estate – Time to take off the Rose-Colored Glasses.

"Returns are below average but stable - but there is a widening disparity of returns across property sectors - cap rate spreads are near long-term averages and could mitigate pressure on cap rates from interest rate increases - investors are becoming slightly more optimistic but cautious that the market will peak sometime this year or next year - increasing interest in debt investments."

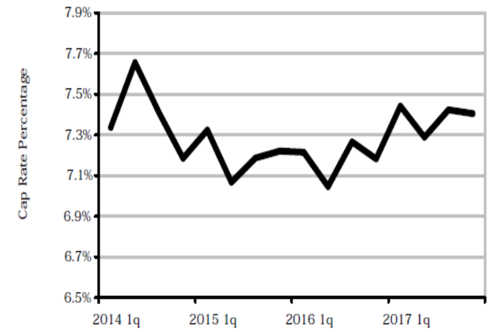
—Jeffrey D. Fisher, PhD. - RealNex

Historical Price/SF Average
Based on Office Building Sales of 15,000 SF and Larger



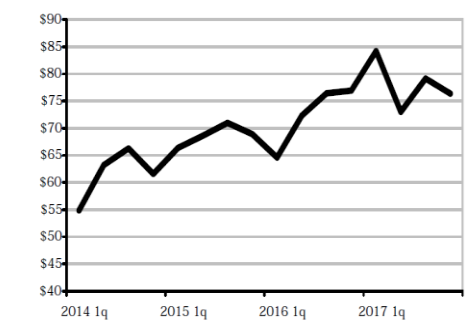
Source: CoStar COMPS®

Historical Cap Rate Average
Based on Office Building Sales of 15,000 SF and Larger



Source: CoStar COMPS®

Historical Price/SF Average
Based on Industrial Building Sales of 15,000 SF and Larger



Source: CoStar COMPS®

Historical Cap Rate Average
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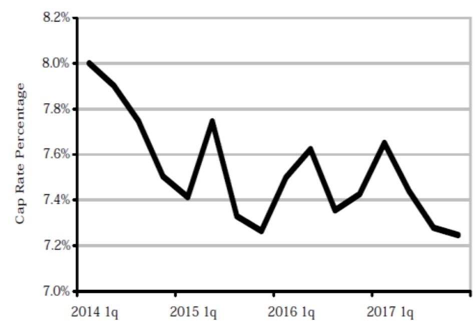

Source: CoStar COMPS®

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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.

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