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Changes ahead for 2018? - by Jonathan Avery

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As we approach the end of the first quarter of 2018 it is a good time to take stock of some emerging trends and what they are signaling for the year ahead. The Federal Reserve members appear committed to raising interest rates (possibly several times) this year, the inventory of homes for sale is low and prices continue to rise, and industrial properties have become one of the preferred investment classes.

The Fed seldom shows all its cards at once, however the signals are clear that inflation is a concern. The obvious response to this concern is a commitment to raise interest rates as shown in the just release minutes of the late January meeting of the FOMC. From the historic lows following the Great Recession, 2017 saw rates being increased. This will likely be a fluid situation as economists carefully watch the impact and monitor inflation. It doesn’t appear their intent is to not allow any inflation since a small measure is often considered a requirement for economic growth – but keeping their eye on the target rate of 2%. Their moves on this front are already being seen in rising mortgage rates which will result in some slowdown of what some consider an overheated market for homes and investment properties.

The housing market remains quite strong with some believing that certain markets are approaching “bubble” conditions. Locally and in many high demand markets, lack of inventory is fueling continued price growth. The S&P CoreLogic Case-Shiller Home Price Index reports that prices continue to increase nationally – plus 6% in their 10-city index and plus 6.3% in the broader 20-city index during 2017. They note that in the 20-city index, the average home price has increased 62% from the lowest point of the financial crisis while inflation in that nearly 10 year period, was 12.4%. Locally, Banker and Tradesman reports in their annual review that the median sale price increased 5% in 2017, reaching a new record high of $365,000 statewide. At the same time the number of single-family home sales decreased 1% (102 sales). Clear evidence of the impact of a short supply in the face of strong demand. These statistics are not uniform across the state however. All counties experienced an increase in median price ranging from +10% in Suffolk County to +2% in Hampshire County.

The investment market has also shown good strength in most sectors although the retail sector continues to face many challenges. One bright light (in large part due to its turnaround) is the industrial property market - in particular, the warehouse/distribution sector. The strong expansion of e-commerce has driven demand as more retail companies enter and expand in this space. The increasing trend of new construction has combined with the decreasing vacancy rates in existing space to expand this market to meet demands. REIS reports that cap rates have been sustained in the mid to low 7% range and that sales volume decreased slightly. 4Q2017 vs. 4Q2016 the average sale price increased. Overall the industrial sector has demonstrated sufficiently strong investment performance to make it even more attractive for institutional investors to use it as a means of diversification to offset risk in other sectors.

What does it all mean? 2018 is shaping up as a year of change for sure. The financial markets are likely in for corrections both on the equity side and increased borrowing costs resulting from Fed monetary policy. Careful attention should be paid to the housing market. I don’t see a “bubble burst” occurring but increased borrowing costs coupled with the impact of the new tax law limiting deductions on state and local taxes, may apply the brakes – not necessarily a bad thing. Finally, the investment real estate market may also see an impact from increased costs of borrowing. However, continued economic expansion fueled in part by the changes in tax laws suggest the industrial sector will continue to be a good place to invest.

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