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Foreign investors and "secondary" markets

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One of the more interesting factors influencing the current state of the real estate capital market is the increased presence of foreign investors seeking deals in domestic US property markets. While the global economy is well established and foreign investment in the US is not new, significant increases in foreign capital seeking assets are influencing not only transaction activity in primary markets - traditionally a small set of coastal/gateway markets - but selectively extending to certain "secondary" markets.

At a recent real estate meeting in Vancouver, foreign capital flows were discussed and the levels of 2013 transaction activity examined in the top 20 markets. During 2012-2013, approximately 10%-12% of all transactions involved cross boarder sales. Manhattan remains the top destination for foreign investors and Boston, LA, Chicago, Washington DC and San Francisco comprise the remaining top 6 markets of foreign real estate investment activity. In 2013, foreign real estate investment in those top 6 markets totaled approximately $19.78 billion out of $101.70 billion of total activity in those markets (or 19%). By comparison, $10.49 billion of foreign activity was completed out of a total $103.30 billion (10%) in the remaining 14 markets comprising the top 20 (including Atlanta, Dallas, DC/VA suburbs, Denver, Houston, Inland Empire, Las Vegas, Miami, Northern NJ, Orange County, Phoenix, San Diego, San Jose and Seattle).

The magnitude of foreign investment activity in the gateway markets was well known, but the level of activity in the next group of markets was of great interest. Increasing interest in growth markets influenced by energy activity was attributed to Houston and Dallas while Atlanta and Phoenix attracted attention due to population growth activity. Although small in total dollars, markets outside the top 20 with sales growth exceeding 100% included Reno, Indianapolis and Nashville. As such, the investment activity in this next group of markets (outside the top 6) is significant.

Reasons attributed to these trends include:

* Diversification of US market exposures: While foreign investors have a long, consistent track record of investing in primary US real estate markets, they are now seeking ways to diversify the significant exposure they have accumulated in the top 6 US markets.

* Pricing Pressure: Generally, foreign investors have targeted going in cap rates approximating 5% with 7-10 year IRRs of 7%. As US core and primary markets have strengthened, the ability to execute in this range has become more challenging and foreign investors are looking outside the traditional top 6 markets for additional return.

* Population growth: As foreign investors continue to build portfolio exposures they tend to be more attracted to markets with population growth to support growth assumptions in their analysis. Much of the population growth has been occurring outside the top 6 markets.

The end result of these various factors has influenced foreign investors to look outside the traditional US gateway markets and to seek deals in the "next set of growth cities" in search of slightly more favorable returns with favorable growth prospects without significant amounts of competing capital.

2014 Calendar of Events

* June Summer Social Event - Date and Location TBD
* "Hot Topics" Luncheon, September 2014, TBD
* 2014 Annual Convention, October 26 - 29, 2014 - Fairmont Copley Plaza - Boston, MA
* November/ December Event TBA

2014 New England CRE

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Jill Hatton, CRE, is the 2014 New England/Upstate N.Y. CRE chapter chair, Boston, Mass.