



# nerrej

## Alternative investments and the rate pile

September 11, 2014 - Appraisal & Consulting

The pricing of commercial real estate investments is determined by the market alternatives. For institutions, alternative investments include private and public equities, fixed income bonds, short to long, and various other alternatives. Allocations for commercial real estate investment generally have been stable during this recovery. The FED monthly bond buying will be over in a month or so. The FED will raise rates in 2015. The rates and yields in the marketplace have anticipated a 2015 scheduled increase in pricing. However, investors have become increasingly edgy as 2015 approaches. The recent volatility in the public securities markets is widely attributed to the 2015 event, notwithstanding the persistent all too serious global crises. Remember the FED action to normalize the market conditions by withdrawing the FED's extraordinary efforts to ease credit are based on data and analysis supporting a sustainable economy. That is good news!

The commercial real estate capital stack is priced variously against alternative investments of similar risk, duration, liquidity and amount. The volatility in the public markets nevertheless has had a limited rippling impact on the pricing of the capital stack. Rates have increased gradually as 2015 approaches; however, tougher underwriting and terms have mitigated even rate increases. Good fundamentals, balance of supply and demand, and modest inflation have provided stability, attraction and appeal to the commercial real estate alternative. Differentiating characteristics of the alternative investment sectors will continue to impact rates and yields differently. Many maintain that capitalization rates (shortcut measure in real estate of current income and value or price like price earnings ratios is enterprises) move independently of rates in the capital markets. Accordingly, some expect the run-up to 2015 and after will not impact cap rates. Some disagree and upward pressure on cap rates and marginal increases.

The FED will release Economic Projections, revisited quarterly, with the minutes of the FOMC. The June Projections released June 18, 2014 were very similar to Projections released in March with the exception of GDP for 2014 which was reduced marginally because of the overall first half 2014. August jobs data were a disappointment; however, the stock market reacted well, and moved positive. The FED Forecast includes moderate growth and stability in economy and markets consistent with objectives and communicated strategy. However, the FED's next steps toward normalized market conditions are unprecedented just as the initial extraordinary steps to ease credit to stimulate the economy. The FED has repeatedly espoused gradual and transparent strategy to maintain growth and stability. So far, so good!

David Kirk, CRE, MAI, FRICS, is principal and founder of Kirk & Company, Real Estate Counselors, Boston.