



CELEBRATING
55 YEARS

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Revisiting the case for real estate (again)

September 11, 2014 - Appraisal & Consulting

Nearly 2-1/2 years ago an article submitted for this column noted real estate should benefit among asset classes in the low interest rate environment given its income stream and capital appreciation, low levels of supply and property values below replacement cost. The consensus expectation in early 2012 was interest rates would gradually rise by 2014 as economic growth recovered and global demand improved.

Where we are today in 2014 is very different. Real estate values have recovered and investors are taking more risk, pursuing investments in secondary markets and value add/opportunistic deals. GDP is barely at a 2% annual pace, rates remain low and the Fed, while announcing that it expects its taper to end in the fall of 2014, does not expect it will raise short term rates until possibly mid 2015. In addition, global growth is slowing and Europe is showing signs of potential deflation and a Japan-like economic environment.

Following are several (but not all) factors that have impacted current conditions and why I would suggest real estate, even at its "fully priced" state, remains a favorable investment and asset class.

- * GDP is likely to remain at approximately a 2% annual rate. GDP has declined gradually since the 1970's and lower levels of business start-ups, leveling of productivity rates and moderating working age population growth support this expectation.

- * The Fed is expected to be more conservative in raising interest rates as moving too early may be more harmful than being a little late. While some financial models imply the Fed should start raising rates given price increases, other analytics challenge that current inflation may be overstated and lack of wage inflation is a more accurate indicator of low inflation, thus supporting Fed restraint.

- * Interest rates in the US have remained low due to lower than expected levels of global nominal GDP growth as well as increased foreign purchases of Treasuries.

These factors tie back to several themes noted in early 2012:

- * Lower interest rates create challenges for savers but should be a positive influence on assets with dividend income and cash flow. Commercial real estate falls into this category.

- * Even though real estate comprises a significant portion of the "Global Market Portfolio" institutions struggle with a 5-10% allocation. Major institutional investors continue to use long-term actuarial annual return assumptions of 7-8%, which will continue to challenge underfunded plans in a low rate environment. Real estate can assist in achieving targeted portfolio objectives through its income and appreciation.

- * Ongoing deleveraging of the global economy should continue to constrain new construction. This positions real estate to capture increased income over the long term against a backdrop of limited interim additional supply.

Commercial real estate will be one of the few investment areas that can provide income and total return in this low return environment. As demand for real estate increases, continue to focus on

in-place cash flows and realistic mid-term assumptions (i.e. limited growth). Solid fundamental underwriting will reward investors over the long term.

2014 Calendar of Events

- * "Hot Topics" Luncheon, September 16, 2014, CBRE/New England | Valuation & Advisory offices
- * 2014 Annual Convention, October 26 - 29, 2014 - Fairmont Copley Plaza - Boston, MA
- * "Update on the Hospitality Market in the Seaport, Boston and Beyond", Ken Wilson, CRE, November 18, 2014 Location TBA

2014 New England CRE

Chapter Officers

- * Jill Hatton, TurtleRock Investment Mgt., chapter chair and secretary;
- * Peter Nichols, NorthStar Ally LLC, vice-chair;
- * John Baczewski, Real Estate Fiduciary Services, LLC, treasurer;
- * Donald Bouchard, Lincoln Property Company, membership vice chair;
- * Julie McIntosh, Capital Crossing Servicing Co., LLC, board member;
- * Martha O'Mara, Corporate Portfolio Analytics, board member; and
- * Harris Collins, CB Richard Ellis - NE Partners, board member.

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

The New England Counselors wrapped up their year of activities with the Annual Holiday Reception at the Algonquin Club in Boston on December 13, 2012. The first meeting of the 2013 will feature Ray Torto, CRE, Ph.D. and Global Chief Economist in Global Research and Consulting at CBRE. Ray will provide his Commercial Real Estate Economic Outlook to the New England Counselors at a Luncheon on January 22, 2013 at his offices. Invitations have been sent to CRE members.

Following are CRE New England Chapter Officers for 2013.

2013 Chapter Officers

Jill Hatton, Real Estate Consultant, Chapter Chair
Peter Nichols, NorthStar Ally LLC, Vice-Chair
Robert E. Costello, Capital Crossing Servicing Co., LLC, Board Member
Martha O'Mara, Corporate Portfolio Analytics, Board Member
Harris Collins, CB Richard Ellis - NE Partners, Board Member
John McLaughlin, McLaughlin Investment, Inc., Board Member
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