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CELEBRATING 55 YEARS

CRE Message: Pricing and capital flows still strong

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Broach the subject of commercial real estate values these days and you will likely get a host of reactions ranging from laughter to knitted brows and a slow shake of the head. Cores assets are trading at unheard of levels with Back Bay retail prices pushing well north of $1,000 per s/f, downtown office buildings trading at mid-4% going in cap rates and investment grade apartments achieving unit prices that...well you get the picture.

While no one can predict the future, there is at least some ability to comprehend the present if we take a moment to reflect on market conditions. Sometime back just after the earth had cooled and I was sitting in my freshman macroeconomics class, I was introduced to the three causes of inflation: demand-pull, cost-push, and monetary policy via the expansion of the money supply. Demand pull was described as inflationary conditions produced by strong demand for commodities that have limited supply. In this case, the commodity is investment grade real estate in core markets. Demand is being fostered by substantial domestic and international capital sources that are awash with both debt and equity funds seeking investment opportunities.

The pressure on those individuals and organizations charged with investing our money is enormous in the current environment. Each deal is attracting high levels of interest from buyers across the spectrum. Making the numbers work has become a creative exercise to say the least with every possible point of potential arbitrage being baked into the Argus cash flow model of the day. Conservative underwriting will lose the deal. Consolidated yield requirements have been driven down to record low levels as a result of excess capital supplies and low interest rates. A perfect storm of sorts?

Bear in mind that not all markets are created equal. Those of us who deal in the greater Boston dynamic are seeing the cutting edge in prices and expectations similar to San Francisco, New York City and Washington, D.C. Institutional capital sources remain reluctant to explore some secondary and tertiary markets where the reward for a limited increase in risk can be substantial. One investor that I know who is active in the New Hampshire market suggests that it is at least a 250 to 300 basis point upward differential for going in cap rates in situations where the risk is similar to deals being seen in the suburban Boston area. Niche players who are able to come to an understanding of these non-core markets can achieve yields that are substantially greater than those being chased in the so-called prime markets. The one limitation that is hard to overcome is deal size with limited opportunities for those seeking larger investments.

As long as the Federal Reserve keeps interest rates in check, the pattern is likely to endure. After all, real estate always goes up in value right?

Before I end I want to thank all of the officers of the New England CRE chapter for their past and continued efforts in the operation of this organization. In addition kudos to Jill Hatton, CRE for her strong leadership as chapter chair these past three years...tough shoes to fill!

To all, enjoy the New Year!

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