

2018 Market Forecast

*Fred Schmidt
Coldwell Banker Commercial*



2017

In Bridge, you have wild cards (Trump cards).

The trump cards are really wild, because they change from hand to hand depending on the bidding.

Source: Bridge for Dummies, Definition of a Trump.



2018

*"It ain't what you do know
that gets you into trouble.
Its what you know for sure
that just ain't so."*

Mark Twain

*Is "Reverting to the
Mean" too mean?*



Tailwinds

- Handoff from Monetary to Fiscal Policy
- Reduced/Softer Regulatory Environment
- Tax Overhaul – First In Over 30 Years (see slide)
- Infrastructure Investment ?
- Business/Consumer Sentiment Very High.
- Positive Employment - Average 2.5 Million Per Year For The Last Few Years (despite monthly aberrations) 331,000 for February 2018.
- GDP – 2.75 to 3.00% YE

Headwinds

- Tapering Sales – Pricing Discovery
- Increase Deficits - \$ 1 Trillion A Year
- Event Risk-Trade Wars -Weather
- Sovereign Debt Crisis – Increased Debt Around the World
- Interest Rate Rising – 10 Year T Bill Up
- Changing Environment For Our Customers (the Uberification of everything)
- Fed Unwinding Balance Sheet

Tax Bill And CRE

Tax Bill And CRE

Exhibit 1-14 Potential Tax Reform Implications for Real Estate



Source: PwC Real Estate Tax Alert.

Tax Bill And CRE

Pass-through Income

- One of the biggest “wins”: Changes to the way pass-through income is taxed
- Mainly apply to
 - Individuals and family trusts investing in real estate
 - Individuals who receive income from REIT dividends

Tax Bill And CRE

1031 Exchanges

- Preserves the 1031 tax-deferred exchange rules
 - Allow investors to defer capital gains on the sale of a property by reinvesting proceeds into another qualifying “like-kind” property.
- Key change: Can only be used to defer capital gains on the value of real estate property
 - Excludes any value on personal property
- Negative tax impact on real estate assets that contain a high amount of personal property
 - Ex. Restaurants that have significant value tied up in the furniture, fixtures and equipment.

Tax Bill And CRE

Change in Depreciation Schedules

- The time owners can depreciate a property reduced
 - Residential Rental: 27.5 years to 25 years
 - Commercial: 39 to 25 years

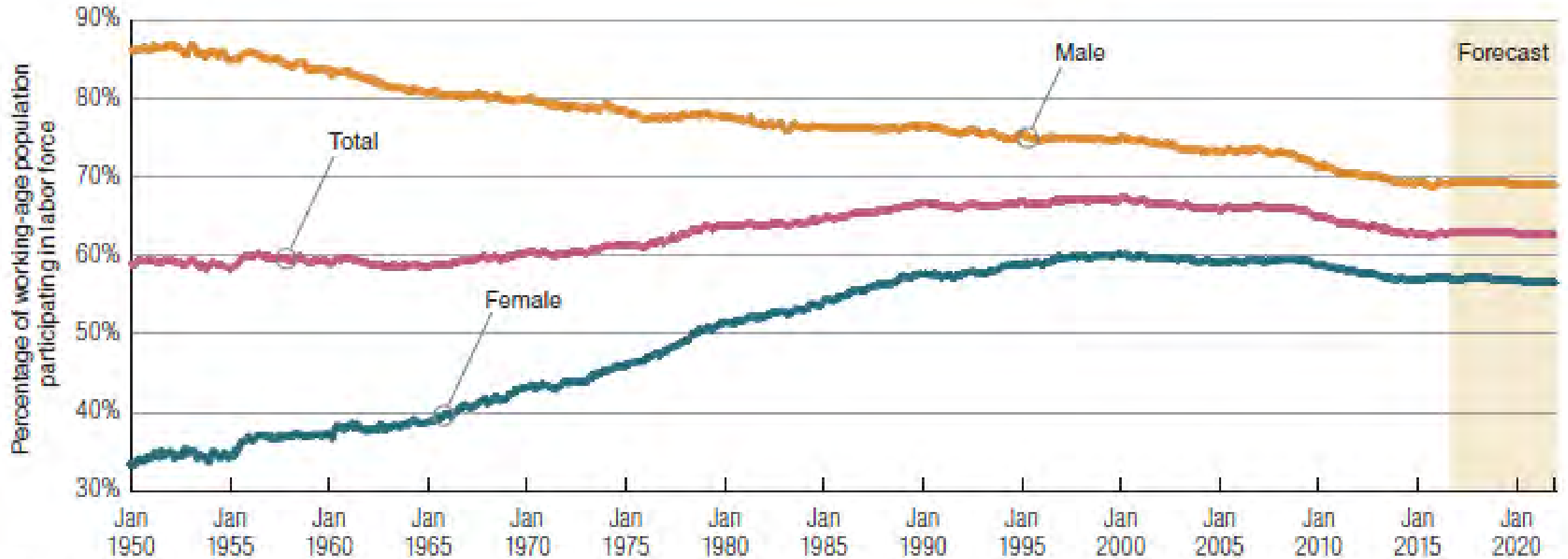
Asset Depreciation

- Businesses can immediately expense the purchase of an asset
- Positive: Investor is deducting an expense rather than recognizing taxable income

Carried-Interest

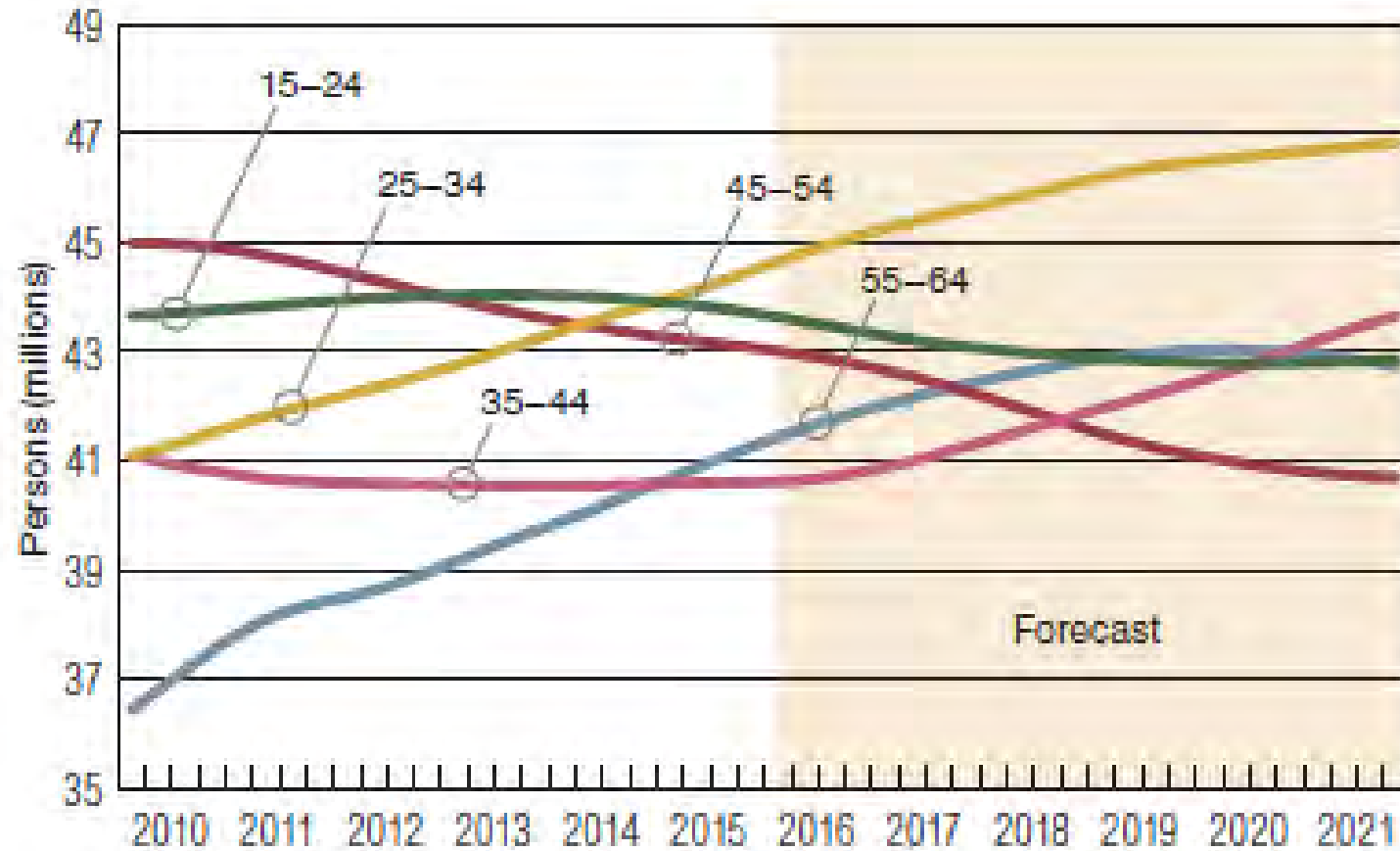
- A moderate provision that changes the hold period to qualify for the capital gains rate from one year to at least three years
- Could also affect real estate investors on a fix-and-flip strategy

Percentage of U.S. Working-Age Population Participating in Labor Force, 1950-2020



Sources: U.S. Bureau of Labor Statistics, "Current Population Survey"; Moody's Analytics forecasts.

Age of U.S. Working Population, by Cohort and Year



Source: U.S. Census Bureau.

Ten Year T Bill Chart



Primary Employment



Education



Medicine



Technology

TAMI

Major Cities /MSA's

- **Technology**
- **Advertising**
- **Media**
- **Information**

FIRE Sector

- **Finance**
- **Insurance**
- **Real Estate**

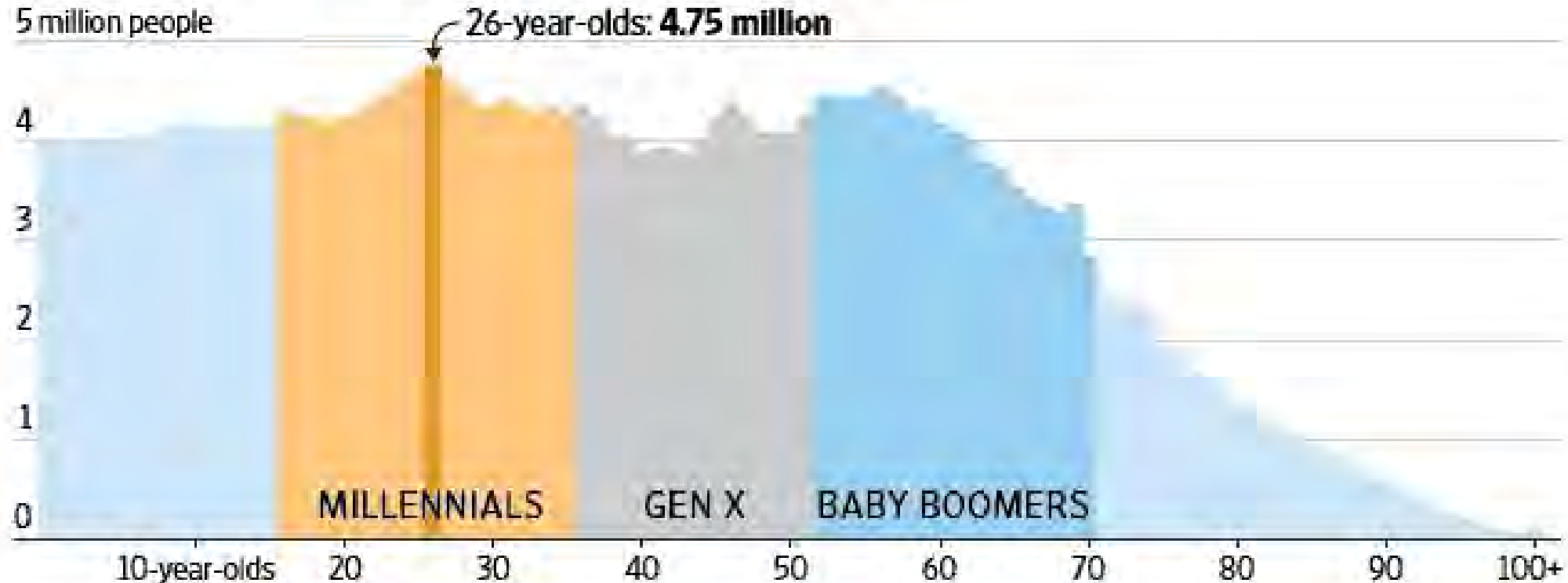
*Major Demographic
Shifts*

Major Demographic Shifts

Millions Ready to Spend

Millennials have replaced baby boomers as the largest generation—with 26-year-olds as the largest single age group—creating a wave of consumers for companies to target.

U.S. population by age, December 2016



Major Demographic Shifts

MILLENNIALS

76+ Million

Born: 1980-2000

GENERATION Z

70+ Million

Born 1998-2017/18

city vs. suburbs?



families?

employment?



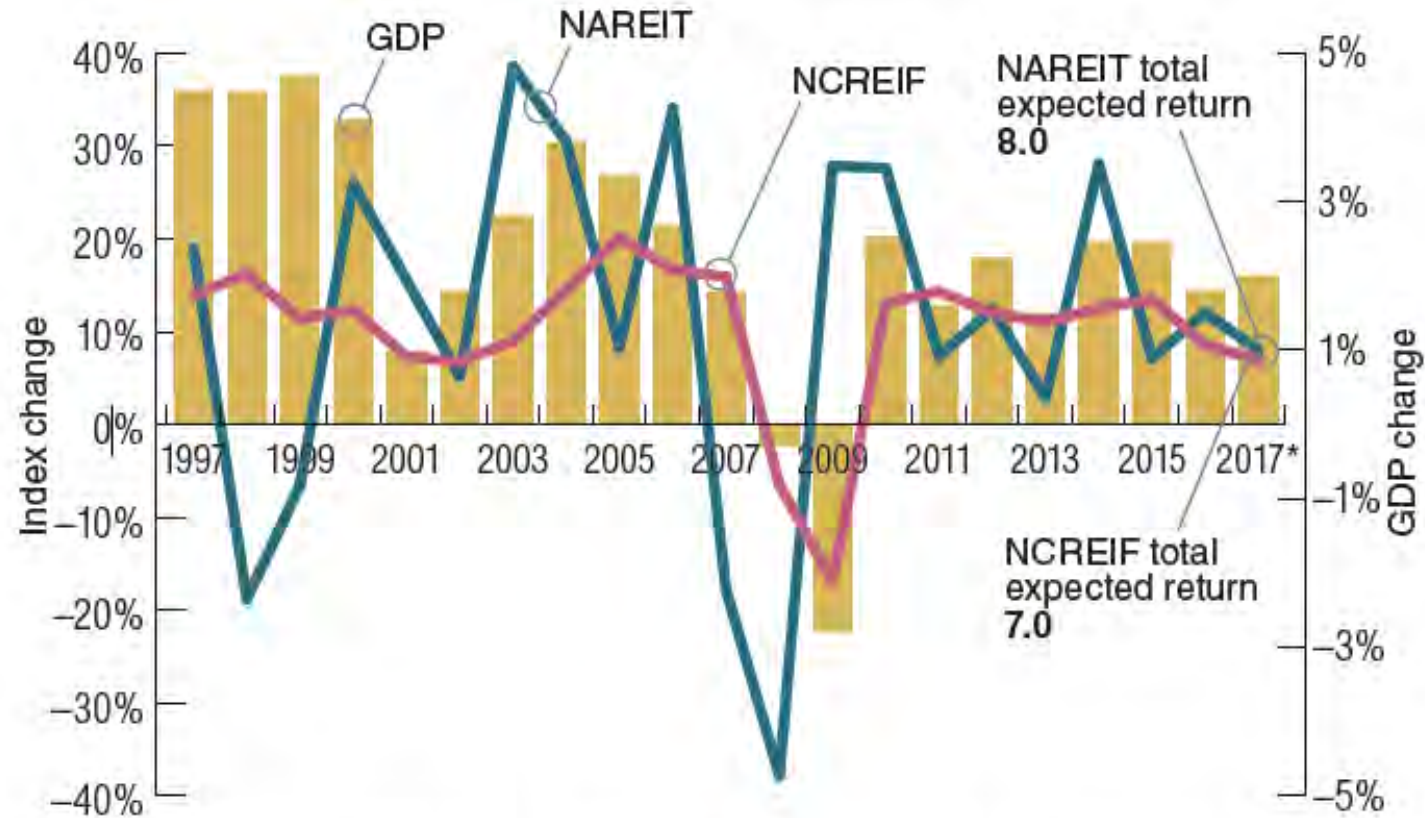
Major Demographic Shifts

Exhibit 1-10 “It isn’t what you don’t know that you should be worried about; it’s what you think you know.”

Cohort	What we thought we knew	What we need to know
Baby boomers	Will retire early to mild climates and enjoy the wealth they accumulated in their peak earning years.	Continue to work due to financial necessity or by choice. If they do leave suburban home, it is to relocate where their kids are or possibly to urban core of own metro area.
Gen X	Bigger houses in the suburbs and a steady climb up the corporate ladder.	Rocked by the GFC, leading to lower rates of homeownership, more focus on work/life balance; will be less financially ready for retirement than previous generations.
Millennials	Users of the sharing economy, love urban living; financial conditions and choice will keep them in the major urban cities.	Are increasingly forming households and having kids; looking at select suburbs and secondary markets for quality of life and cost
Gen Z	Tech savvy from birth; will have grown up in the sharing/gig economy; will converge on the urban core and solidify all other millennial trends.	?

Emerging Trends

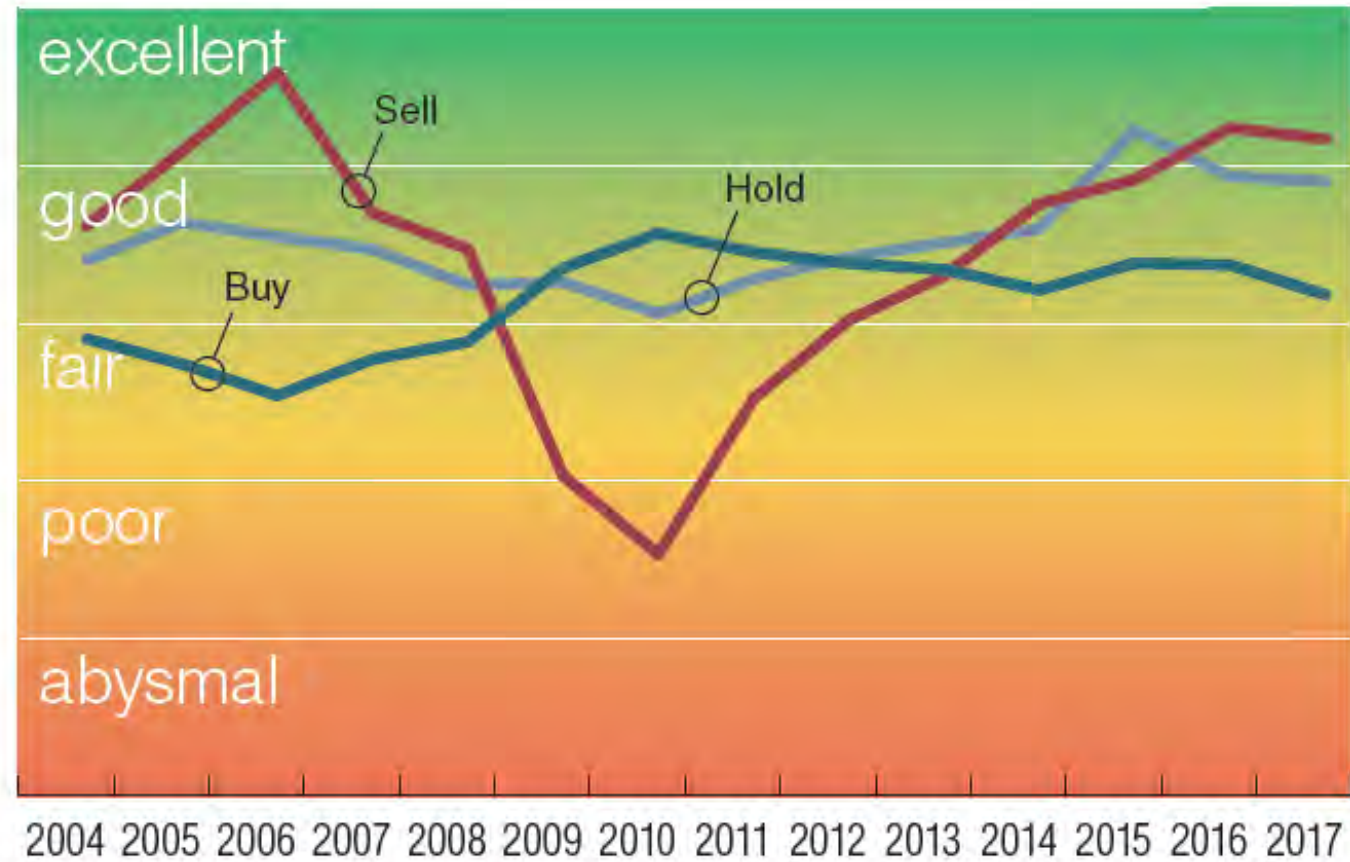
U.S. Real Estate Returns and Economic Growth



Sources: NCREIF, NAREIT, Bureau of Economic Analysis/U.S. Department of Commerce, *ULI Real Estate Consensus Forecast*.

*NCREIF/NAREIT and GDP data for 2016 and 2017 are based on forecasts for these indicators in the *ULI Real Estate Consensus Forecast*, October 2016.

Emerging Trend Barometer 2017

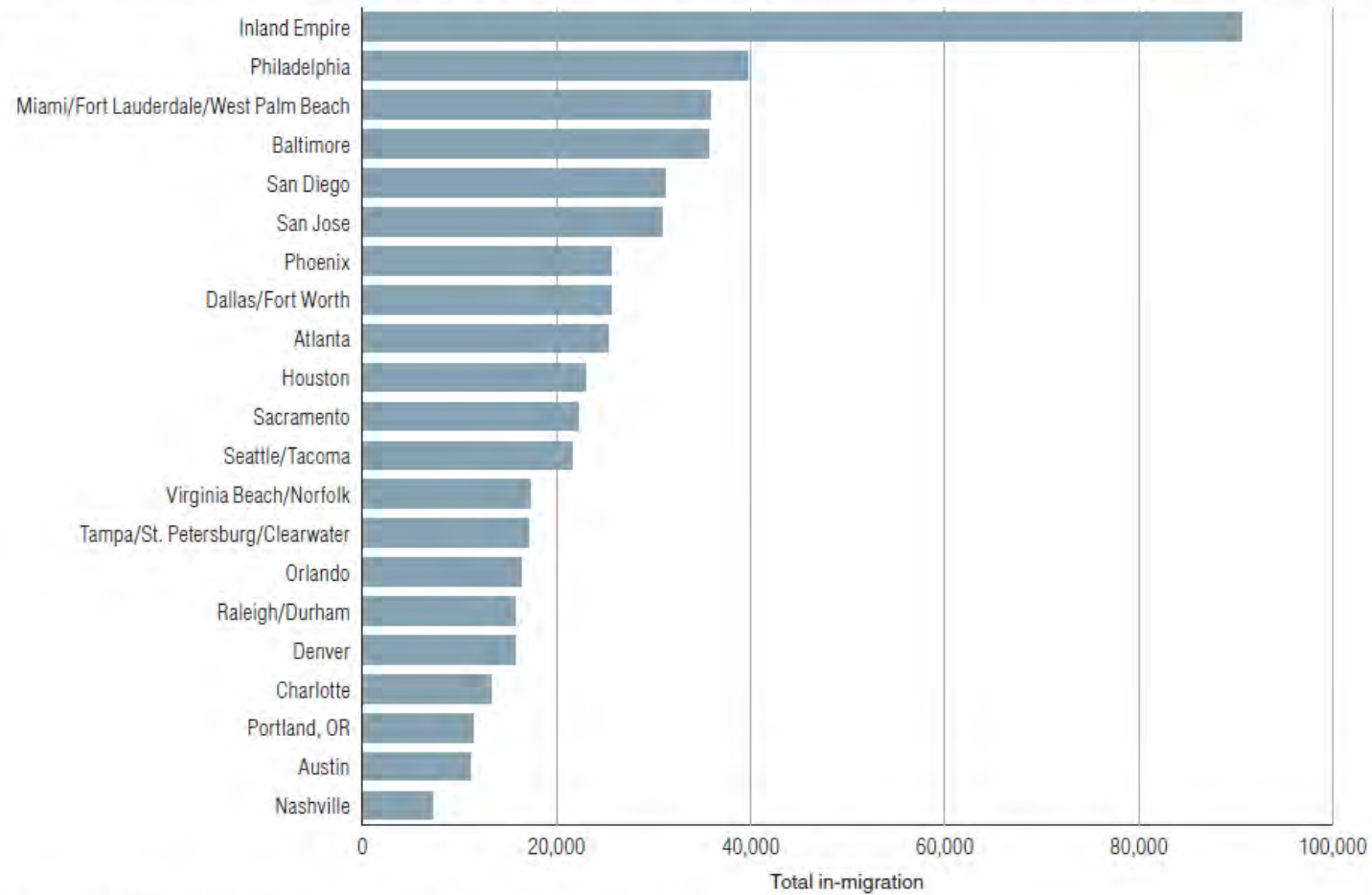


Source: *Emerging Trends in Real Estate* survey.

Note: Based on U.S. respondents only.

Top Destination Markets for Migration from Primary Markets

Exhibit 1-11 Top Destination Markets for Migration from Primary Markets, by Total In-Migration, 2011–2015



Source: U.S. Census Bureau, Metro Area-to-Metro Area Migration Flows, 2011–2015.



Trends

Office:
Vacancy – 16.10% / 
Rent -  0.5%

Retail:
Vacancy – 10.10% / 
Rent -  0.4%

2018
Trends

Industrial:
Vacancy – 7.60% / 
Rent -  0.4%

Multi-Family:
Vacancy – 4.80% / 
Rent -  0.1%

Systemic Shifts-Manifesting



Decreasing Office Space



Omni-Channel Approach



Influence of Distribution Hubs



Surge in Multi-Family

Shared Economy

Live - Work - Play

wework

NEWLAB

 **Serendipity Labs**
Inspiration at Work.®


Regus

UBER

Storefront

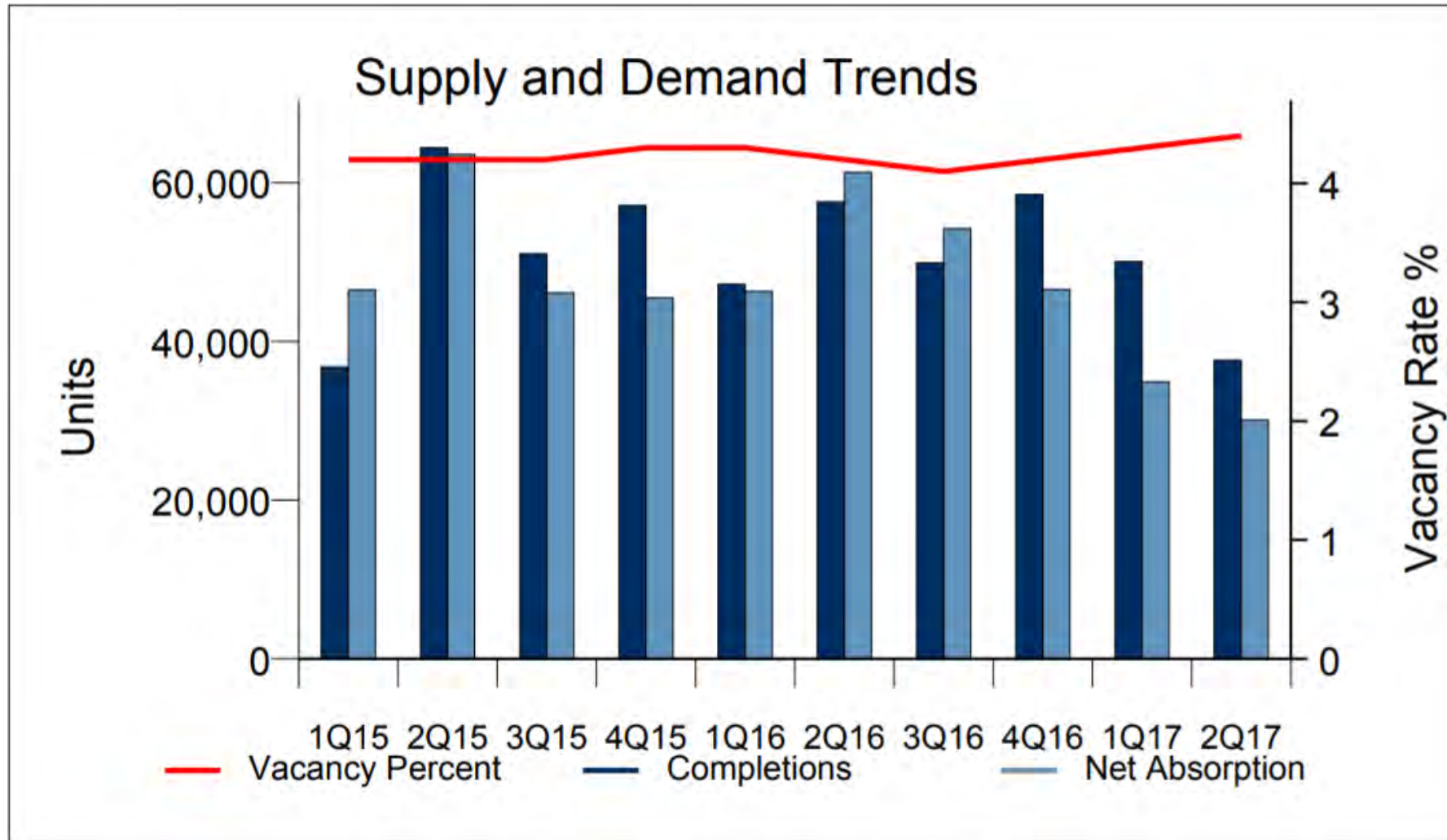
 **airbnb**



FUNDRISE

Apartments

Apartments



Apartments – Vacancy & Rent Trends

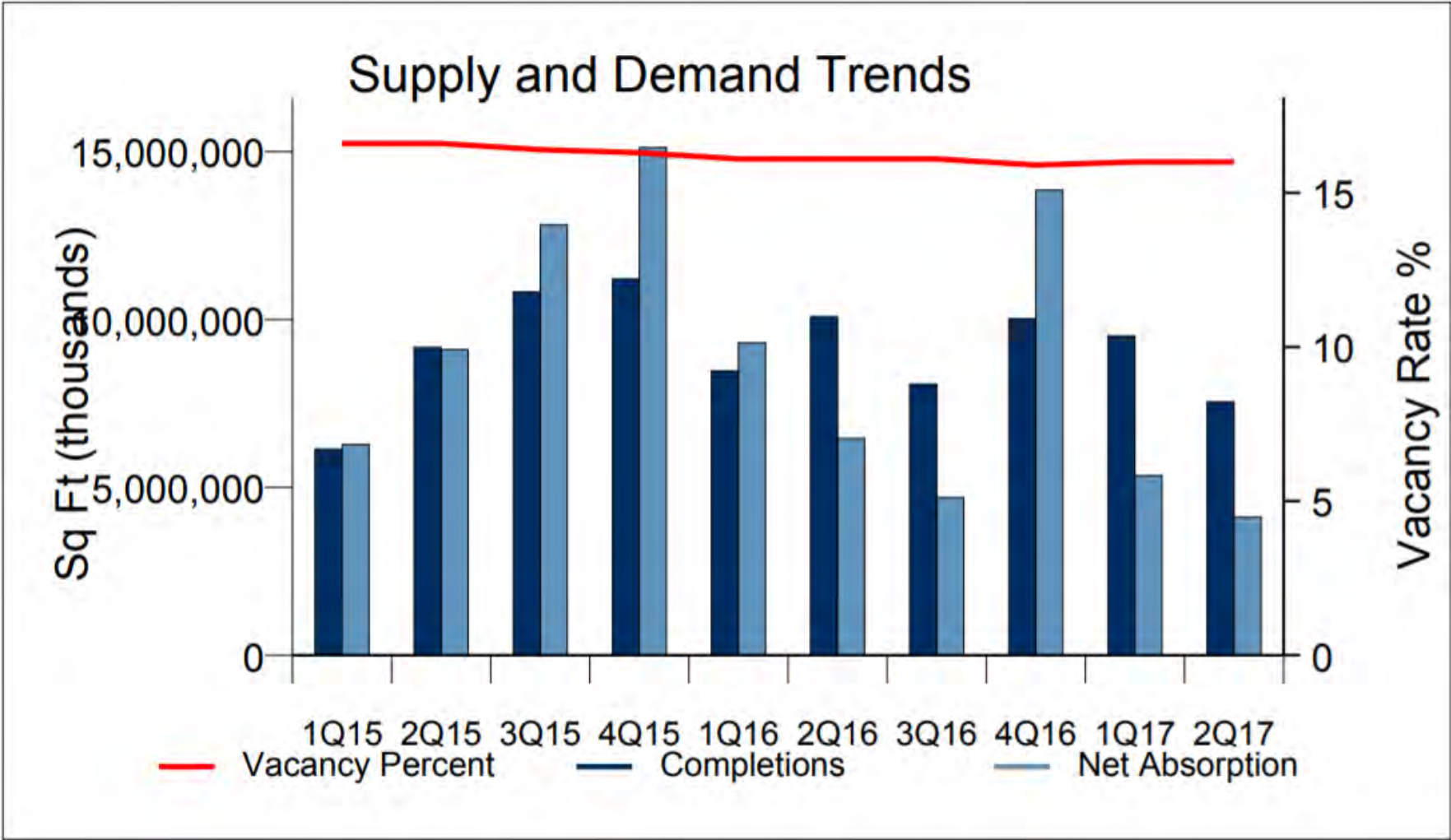
Metro	2017 Vacancy (YE)	2018 Projected Vacancy	2017 Asking Rent (YE)	2018 Projected Asking Rent
United States	4.5	5.0	\$1,368	\$1,419
Midwest Region	4.3	4.7	\$1,052	\$1,088
Northeast Region	4.2	4.8	\$1,916	\$1,988
South Atlantic Region	5.0	5.4	\$1,197	\$1,240
West Region	3.9	4.3	\$1,642	\$1,704

Apartments

- National vacancies increased to 4.4%
- Supply increasing to meet demand (Class A)
- Asking rents grew by 3.7% and effective rents grew by 3.6% YOY
- Rate of rent increase tapering slightly
- 2015 cyclical highs – asking and effective rents rose by 5.8%
- Demographics driving demand – Millennials and Boomers

Office

Office



Office – Vacancy & Rent Trends

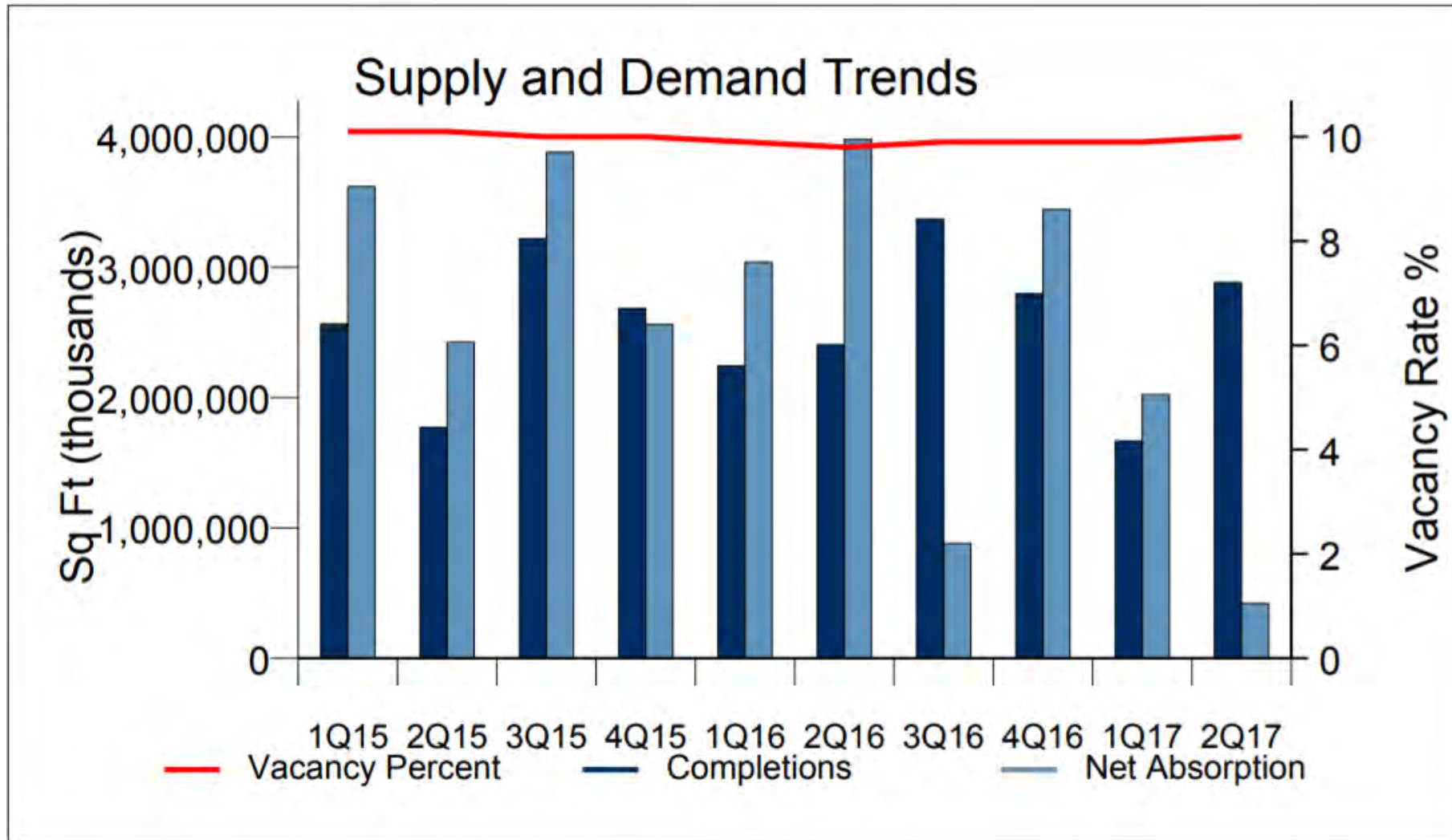
Metro	2017 Vacancy (YE)	2018 Projected Vacancy	2017 Asking Rent (YE)	2018 Projected Asking Rent
United States	16.4	16.5	\$32.58	\$33.22
Midwest Region	18.6	18.6	\$23.98	\$24.38
Northeast Region	13.9	14.0	\$44.79	\$45.52
South Atlantic Region	16.7	16.8	\$28.69	\$29.22
West Region	19.3	19.5	\$25.44	\$25.89

Office

- Office demand follows employment
- Lower Sq. Ft over past 10 years
 - Avg. 150 Sq. Ft vs 250 Sq. Ft 10 years ago
- Space utilization and productivity
- Technology – Work from anywhere
- Free Lance – Contract work
- WeWork/Regus – On demand vs rent

Retail

Retail



Retail – Vacancy & Rent Trends

Metro	2017 Vacancy (YE)	2018 Projected Vacancy	2017 Asking Rent (YE)	2018 Projected Asking Rent
United States	10.0	10.1	\$20.85	\$21.14
Midwest Region	12.6	12.7	\$16.89	\$17.01
Northeast Region	9.3	9.5	\$22.10	\$22.33
South Atlantic Region	9.6	9.6	\$19.86	\$20.16
West Region	11.0	11.0	\$17.54	\$17.83

Retail

- Debunking the Retail Apocalypse
- 4080 Net for Chains with More than 50 stores in 2017i

Headwinds:

- Retail over stored in Malls retail mall growth 4X the population growth over the past 35 years
- Retailers chose growth vs. client experience/service
- Department stores and Apparel drove negative news- Sears, JC Penny, etc.
- Fast Fashion/Off price retailing replace Dept. Stores – H&M, Zara
- Breakout of Cosmetics/Beauty – Sephora, Ulta, Lush
- E- Commerce/Amazon to a point and shoppers controlling price

Retail

Tailwinds:

- Retail is not dying it is changing
- Omni- Channel Approach to the consumer e-Commerce and Bricks
- Retail Sales are up and growing/e-Commerce is 8.3% of growth
- Experience and entertainment retailers will survive and thrive

Industrial

Industrial



Industrial – Vacancy & Rent Trends

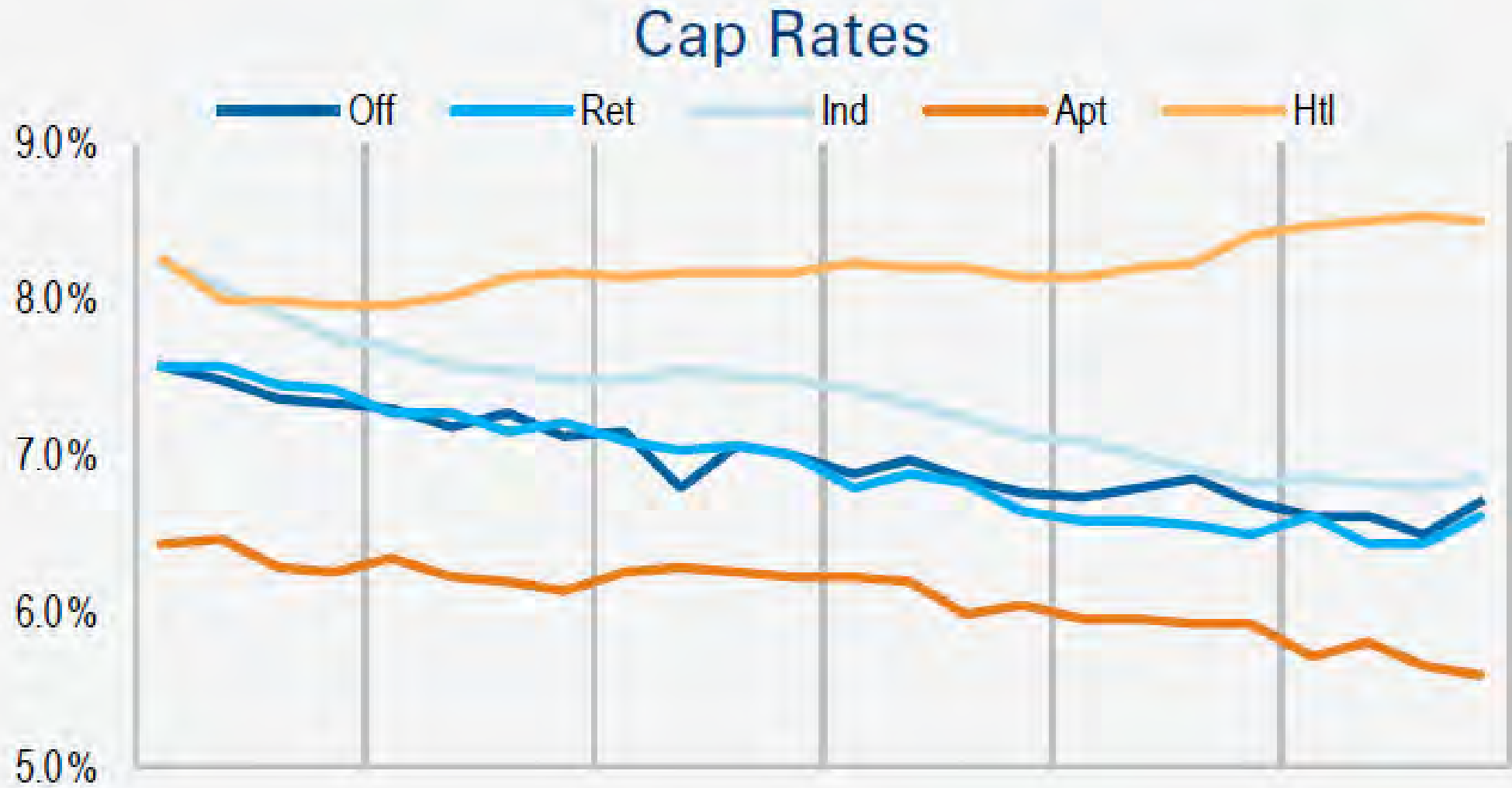
Metro	2017 Vacancy (YE)	2018 Projected Vacancy	2017 Asking Rent (YE)	2018 Projected Asking Rent
United States	7.3	6.8	\$5.30	5.5
Midwest Region	8.1	7.5	\$4.73	4.9
Northeast Region	9.1	8.5	\$4.67	4.8
South Atlantic Region	8.2	7.6	\$5.05	5.2
West Region	8.6	8.1	\$4.50	4.7

Industrial

- Last Mile – Smaller space closer to consumer
- Battle of the supply chains
- Uber type delivery systems
- Panama Canal – Impacts East Coast/West Coast

The Big Picture

Cap Rates



Commercial Real Estate

- Property Type Outlook: More defensive
- Industrial Whse/Dist. – E-Commerce, Omni-Channel, Last Mile to Consumer
- Apartments – Continue to Grow At A Lower Rate
- Office – Depends on Employment, Core Very Pricey – Adaptive Reuse in Suburbs
- Retail: Grocery Anchored, High End Low End

Trends

- Increased Investment & Capitol Flows
- Continued Low Supply
- Increased Appetite for Risk
- Secondary Markets
- Value Add
- Adaptive Reuse
- Investors to Follow Jobs & People

2018 CRE Trends

Niche Plays

- Medical Office
- Mixed Use Lifestyle
- Mixed Use Urban/Exurban
- Data Center- Server vs Cloud
- Student Housing

Best Bets 2018:

- Mid Priced Housing – Multi Family
- Focus On Income Over Potential Appreciation
- Industrial- Last Mile
- Experiential Retail –Food /Fun/Fitness
- Senior Housing Momentum Growing

Make sure you have a Trump Card!



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