

Situs RERC®

REAL ESTATE REPORT

FLASH REPORT | 1Q 2017

Dear Subscribers,

Spring is upon us, and as the temperatures become more subdued, the markets are still on a roller-coaster ride. The “Trump Bump” for stocks appear to be waning as the Dow retreats from a record high set on March 1, 2017. Meanwhile, the Federal Reserve raised its benchmark rate for the second time in three months. While the tightening of monetary policy signals the current vigor of the economy, we should be mindful that large and/or sudden interest rate hikes could be detrimental to commercial real estate (CRE). On the other hand, CRE can provide an inflation hedge because rents can adjust quickly against inflation. As the equity market rally fueled by overly optimistic expectations regarding fiscal, tax and trade policies seems to be stabilizing and bond yields continue to remain historically low, the desirability of CRE investing is of greater relative value.

In order to shed some light on the CRE market, we have enclosed the first quarter 2017 **Situs RERC Flash Report**. This report provides a preliminary look at Situs RERC’s institutional investment survey data. Some of the highlights are:

- Going-in cap rates were relatively mixed with most seeing slight decreases or remaining flat compared to last quarter. There seems to be some choppiness developing as rates approach a potential bottom and prices begin to correct.
- Despite the mixed results for rates among the property sectors, Situs RERC institutional survey respondents maintained that the industrial sector offered the best investment opportunity relative to other major property types because of all-time-low vacancy rates and strong rent increases.
- According to Situs RERC’s institutional respondents, CRE remained the most attractive investment compared to stocks, bonds and cash during first quarter 2017. However, preliminary investment alternatives ratings show that the spread between CRE and cash narrowed significantly since the previous quarter.
- Preliminary value vs. price ratings for CRE overall indicated that respondents were concerned about values lagging prices during first quarter 2017. However, values continued to outweigh prices among the majority of individual property sectors. Compared to the previous quarter, values came significantly under pressure for the retail sector, while the office sector was considered to have more value (relative to prices).
- For CRE overall, risk outweighed return for investors during first quarter 2017, according to respondents, a shift from the previous two quarters. For all property sectors, preliminary ratings were lower than the previous quarter (indicating slightly more risk relative to return), though respondents maintained that returns were equal to or greater than risk for investors. The industrial sector was rated the highest in terms of return vs. risk.
- For the base-case scenario, Situs RERC’s forecast predicts that 10-year Treasury rates will increase to approximately 2.59 percent by mid-2017, 2.98 percent at the beginning of 2018 and 3.25 percent at the beginning of 2019. Situs RERC institutional survey respondents commented that a correction in equity markets could dampen rates, but there is also potential for rates to see dramatic increases.

On a personal note, I would like to thank our survey respondents for their dedication to the research process. Without your commitment and willingness to share your insights, we would be unable to provide this report. Please note that the **Situs RERC Flash Report** contains preliminary data; our complete first quarter 2017 report will be available in mid-May 2017.

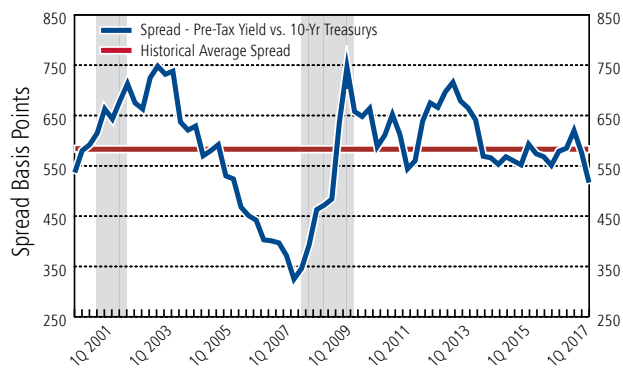
Sincerely,



A handwritten signature in black ink that reads "Ken Riggs". The signature is stylized with a large, sweeping "K" and a cursive "Riggs".

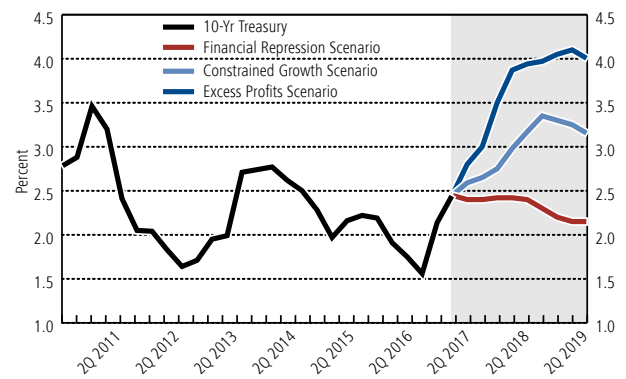
Ken Riggs
President
Situs RERC
riggs@rerc.com

Situs RERC Historical Spread Between Required Pre-Tax Yield (IRR) Rates and 10-Year Treasurys



Sources: Federal Reserve, Situs RERC, 1Q 2017 preliminary data.

Situs RERC 10-Year Treasury Forecast



Note: Readings displayed are quarterly averages. Shaded area indicates forecast.
Sources: Federal Reserve, compiled and forecasted by Situs RERC, April 2017.

Situs RERC Investment Conditions and Current Quarter Capitalization Techniques

	Investment Conditions ¹				Income Approach ²		Cap Rate ³	
	1Q 2017	4Q 2016	1Q 2016	1Q 2015	Direct Cap.	DCF	Before Reserves (%)	After Reserves (%)
Office - CBD	6.2	5.3	5.9	6.4	4.5	8.3	87%	13%
Office - Suburban	5.3	5.3	4.9	5.3	4.5	8.4	87%	13%
Industrial - Warehouse	6.9	6.3	6.4	6.8	5.7	7.5	87%	13%
Industrial - R&D	6.0	5.5	5.1	5.7	4.9	7.4	83%	17%
Industrial - Flex	6.0	5.5	5.7	5.4	4.4	7.8	82%	18%
Retail - Regional Mall	5.0	5.4	4.9	5.7	4.1	8.1	82%	18%
Retail - Power Center	5.0	5.3	5.1	5.4	4.5	7.9	83%	17%
Retail - Neighborhood	6.0	5.9	6.4	6.5	4.4	7.8	86%	14%
Apartment	5.8	5.1	5.5	6.1	6.4	6.0	24%	76%
Student Housing	5.6	5.6	5.6	6.1	5.4	6.4	11%	89%
Hotel	5.3	5.3	5.4	6.6	4.0	8.8	0%	100%

¹ Investment Conditions rated on a scale of 1 = poor to 10 = excellent.

² Income Approach rated on a scale of 1 = least relevant to 10 = most relevant.

³ Percent of respondents who apply the cap rate before or after reserves. See the Scope and Methodology section in the full *Situs RERC Real Estate Report* for more information.
Source: 1Q 2017 Situs RERC Investment Survey, preliminary data.

Situs RERC Expected Leasing Assumptions, Marketing & Holding and Investment Recommendations

	Renewal Prob. (%)	Down Time (months)	Vacancy Loss ¹ (%)	Marketing Time (months)	Holding Period (years)	Buy (%)	Sell (%)	Hold (%)
Office - CBD	69.6	6.9	7.1	5.5	9.7	20	20	60
Office - Suburban	68.6	7.7	9.1	6.9	9.4	50	14	36
Industrial - Warehouse	70.8	6.7	5.3	5.6	9.8	64	0	36
Industrial - R&D	67.0	7.2	6.6	6.9	9.7	45	0	55
Industrial - Flex	66.9	7.7	8.0	7.6	8.8	45	0	55
Retail - Regional Mall	71.1	6.2	6.8	6.3	9.4	18	45	37
Retail - Power Center	68.2	7.4	6.8	6.8	9.3	15	54	31
Retail - Neighborhood	69.6	6.8	6.0	5.6	9.6	36	14	50
Apartment	65.0	2.7	6.2	4.1	9.5	19	38	43
Student Housing	71.3	2.8	6.5	4.8	9.1	40	20	40
Hotel	N/A	N/A	N/A	5.9	9.0	20	30	50
All Types	68.8	6.2	6.8	6.0	9.4	34	21	45

¹ Vacancy loss reflects a typical holding period, not the current level.

Source: 1Q 2017 Situs RERC Investment Survey, preliminary data.

Situs RERC Real Estate Investment Criteria¹ by Property Type – 1Q 2017

	Office		Industrial			Retail			Apartment	Student Housing	Hotel
	CBD	Suburban	Warehouse	R&D	Flex	Regional Mall	Power Center	Neigh/Comm			
Pre-Tax Yield Rate (IRR) (%)											
Range ²	5.3 - 10.0	7.0 - 11.0	5.8 - 10.0	7.0 - 10.0	7.0 - 12.0	6.0 - 8.5	6.5 - 10.0	5.8 - 8.3	5.8 - 9.0	7.3 - 8.0	8.0 - 10.5
Average ²	7.3	8.4	7.3	8.0	8.5	7.5	7.8	7.1	7.2	7.7	9.6
BPS Change ³	-10	20	10	0	20	-10	-20	-20	0	-10	-20
Going-In Cap Rate (%)											
Range ²	4.5 - 7.0	5.5 - 7.5	4.5 - 7.5	5.5 - 8.5	5.5 - 9.0	4.0 - 8.0	6.0 - 7.0	5.0 - 7.0	4.0 - 6.5	5.3 - 6.3	6.5 - 8.5
Average ²	5.4	6.5	5.8	6.5	7.0	6.2	6.5	5.9	5.2	5.8	7.6
BPS Change ³	10	0	0	0	20	0	-20	-10	0	-20	-10
Terminal Cap Rate (%)											
Range ²	5.0 - 7.5	6.3 - 8.0	5.0 - 7.5	6.0 - 8.0	6.0 - 9.5	4.5 - 8.5	6.5 - 7.5	5.8 - 7.8	4.3 - 6.3	6.0 - 7.3	7.5 - 9.3
Average ²	6.0	7.1	6.2	7.1	7.4	6.6	7.0	6.4	5.6	6.5	8.2
BPS Change ³	0	-20	-10	-10	-10	-20	-20	-20	-10	-20	-20
Rental Growth Rate (%)											
Range ²	2.0 - 4.0	2.0 - 3.5	2.5 - 4.0	2.0 - 4.0	1.5 - 4.0	1.5 - 4.0	2.0 - 3.5	2.0 - 3.0	1.5 - 4.0	2.4 - 3.0	1.0 - 3.0
Average ²	2.8	2.6	3.0	2.8	2.7	2.8	2.7	2.8	2.9	2.8	2.3
BPS Change ³	-10	0	0	0	0	-10	20	0	-10	0	-40
Expense Growth Rate (%)											
Range ²	2.0 - 3.0	2.0 - 3.0	2.0 - 3.0	2.0 - 3.0	2.0 - 3.0	2.5 - 3.0	2.5 - 3.0	2.5 - 3.0	2.0 - 4.0	2.0 - 4.0	2.5 - 3.5
Average ²	2.8	2.8	2.8	2.8	2.8	2.9	2.9	2.9	2.9	2.9	2.9
BPS Change ³	10	20	10	20	20	20	20	10	10	20	10

¹ This survey was conducted in January, February and March 2017 and reflects expected returns for first quarter 2017 investments.

² Ranges and other data reflect the central tendencies of respondents; unusually high and low responses have been eliminated.

³ The change in basis points (BPS) reflects the rate difference (+/-) between the current rate and the rate published in the prior quarter's issue of the *Situs RERC Real Estate Report*.

Source: 1Q 2017 Situs RERC Investment Survey, preliminary data.

Please note: The data reflect the preliminary results as compiled by Situs RERC. Our final numbers, which will be published in the full 1Q 2017 *Situs RERC Real Estate Report*, may be significantly different.

HISTORICAL RATES

Contact us for historical rates for the individual property types back to 1989.

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