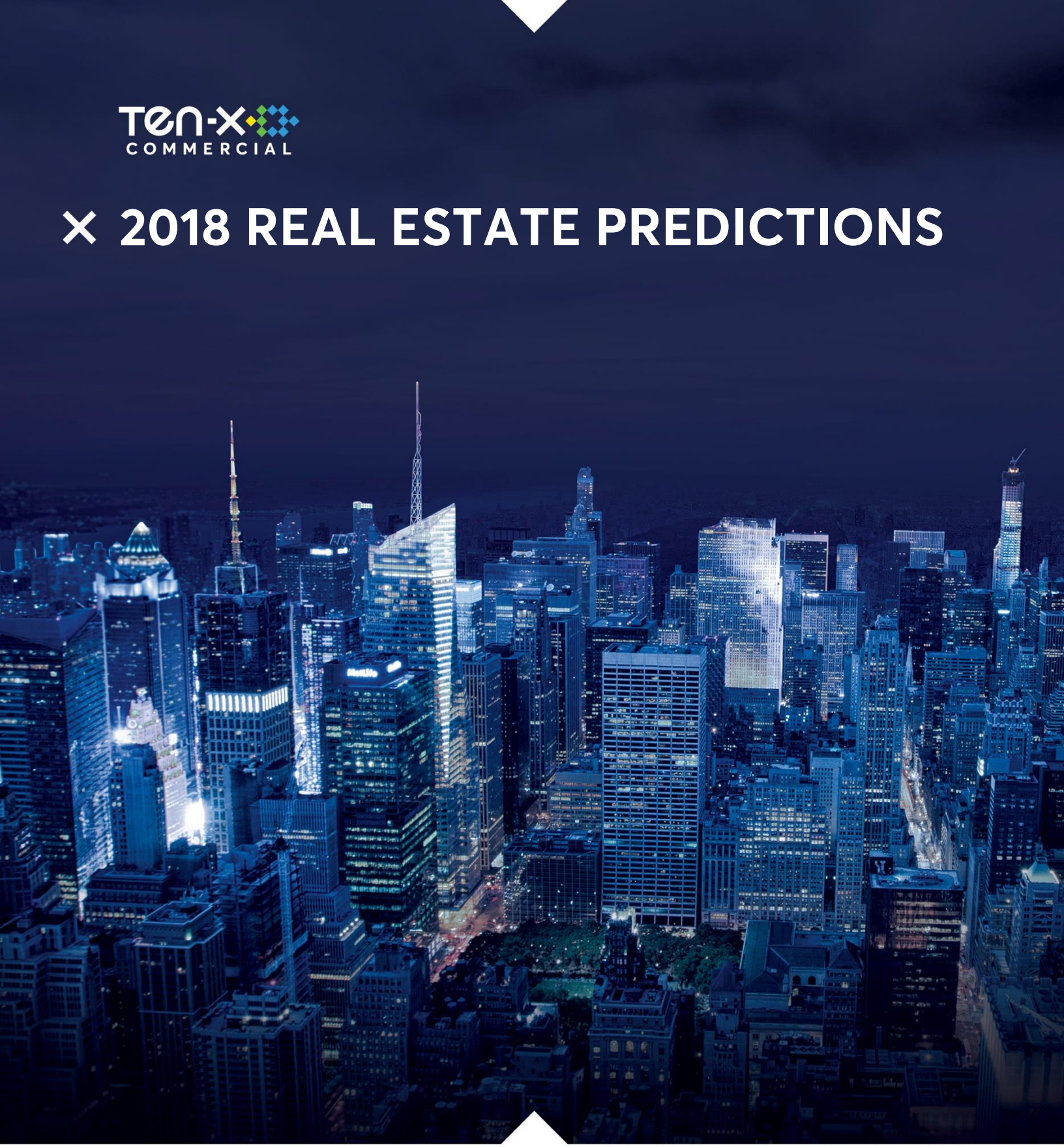
Ten-X COMMERCIAL

× 2018 REAL ESTATE PREDICTIONS



TEN-X RESEARCH

Ten-X Research, led by Chief Economist and industry veteran, Peter Muoio, Ph.D. is based in New York. The group focuses primarily on custom analysis and business development support services, as well as industry-leading data science and predictive modeling initiatives.

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With 2018 rapidly approaching, the Ten-X Research team is taking a look at the current state of the economy and real estate markets and offering up some key predictions for the year ahead.

Economic and CRE Cycles Diverge: One of the developments the Ten-X Research Team has been monitoring is the divergence in the economic and Commercial Real Estate Cycles. The economic cycle has shown no signs of abatement, with a strong labor market continuing to fuel growth. However, this is not translating into improved fundamentals across CRE as it usually does. Retail is grappling with the headwind of e-retail, stunting absorption and constraining NOI. Office markets fall into two camps: some markets are seeing low demand amid more tepid economic situations with other higher beta markets seeing large supply additions rising to match their absorption levels. The industrial sector, which has been benefiting from the rise in e-commerce is now seeing a steady supply pipeline, limiting gains in occupancy. The hospitality sector is fighting heavy supply additions, as well as the rise of home-sharing as an alternative. On the whole, CRE fundamentals remain tepid at best, and this is in the midst of a solid, healthy expansion. This leaves them increasingly vulnerable should the cycle turn.

Mind the Gap Closing: One of the key themes we highlighted in our 2017 Wrap-Up was the divergence in buyer and seller pricing expectations for Commercial Real Estate. This widening of the bid-ask spread was sourced over doubts over the continuation of the cycle on the buy-side, a rise in interest rates heading into the year and seller expectations for robust pricing increases. The end result was a decline in transaction volume from the year prior. We believe this 'gap' will begin to close in 2018, and it will do so due to sellers accepting the new paradigm. The lack of appreciation over the past year will temper expectations, as will continued tepid fundamentals in the coming quarters.

Death and Taxes: This one may get completed by the end of 2017 but the effects will begin to take place in 2018. Tax Reform seems almost certain to pass, with just the final details and harmonization between the House and Senate versions left to sort out. This should be a boost to Commercial Real Estate, as it benefits greatly from the proposed pass-through entity tax treatment and could trigger an influx of capital into the sector. Over the long-term, should the State and Local Tax Deduction turn out to be eliminated or severely curbed, regional migration out of high tax states to lower tax sun-belt states may accelerate further, driving even more regional economic divergences than have been seen in this cycle.

Meet the New Boss, Same as the Old Boss: Early in 2018 Jerome Powell will take over for Janet Yellen as the Chair of the Federal Reserve. However, despite the transition in leadership, we believe the course of monetary policy will be virtually unchanged. His comments point to a similar outlook on the economy as Yellen, with perhaps a slightly higher emphasis on labor force participation rates, which should result in the continuation of gradual interest rate increases and very slow balance sheet unwind. The only place where he may diverge from his predecessor is on the regulatory front, where he is likely to be laxer towards the financial sector.

Dig Baby Dig: It is starting to leak out that once tax reform is a done deal the administration is going to revive talks about a massive infrastructure spending bill. However, given that a large portion of this is going to be centered around a border wall we expect fierce opposition from Democrats and deficit hawk Republicans. This will likely be highly discussed, but not come to fruition in the first six months of the year.

E-Retail Rise Continues: As we mentioned in our 2017 Wrap-Up post, this was year the shift to e-commerce finally shifted into the national spotlight, years after Ten-X Research highlighted the trend. We believe that this trend will not abate in 2018, and in fact E-Retail will move into other traditional retail businesses such as groceries in full force, as evidenced by Amazon's recent acquisition of Whole Foods.

Redevelopment Time: One of the fallouts from e-retail's surge has been significantly higher vacancies in secondary and tertiary mall and other retail properties. We believe in 2018 will mark the start of a redevelopment trend of these properties into mixed-use locations that heavily feature some form of residential property. This is also something outdated, high vacancy suburban office parks will begin to see as well.

Home is Where the Heat Is: The housing market remains the brightest sector of the real estate universe. Inventories are exceptionally low, homeownership appears to have bottomed cyclically and millennials are beginning to enter the ages when homeownership rates typically rise. We expect home prices and sales to continue to rise, as well as the construction of single-family homes. The multifamily construction boom is beginning to fade, and it appears single family is ready to take the baton.

But Location Still Matters: One of the provisions in the proposed GOP tax plan is a cap on mortgage interest deductions over $500,000. This will cause some regional variance in housing market performance, as California, New York, DC, Boston and other higher priced home metros will be disproportionately affected and constrained by the cap. Meanwhile Sun-Belt and Midwest metros will see almost none of their housing stock affected, allowing them a cleaner runway for sales and price growth.

Puerto Rican Migration: The effects of Hurricane Maria on Puerto Rico were devastating and continue to be felt to this day. One of the trends in the aftermath of the storm has been a large migration of Puerto Ricans from the island to the mainland, accelerating a trend that has been in place for several years. This will severely hamper the economic recovery potential of Puerto Rico but will also be a boon to places such as Orlando and central Florida that have seen a large influx from this population. It is estimated that nearly a quarter of a million Puerto Ricans have already migrated to Central Florida, and many already possess experience and skills in the leisure/hospitality industry, the dominant sector in the Orlando economy.

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Peter Muoio, Ph.D.
Chief Economist
212-871-2118
pmuoio@ten-x.com

Chris Muoio
Sr. Quantitative Strategist
212-871-2117
cmuoio@ten-x.com

Cory Loviglio
Quantitative Strategist
212-871-7864
cloviglio@ten-x.com

Matthew Schreck
Quantitative Strategist
212-871-2121
mschreck@ten-x.com