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Economic and Real Estate Market Predictions

I, like a number of real estate professionals, have been making the rounds of the 2015 forecasts for the commercial real estate industry and reading the various predictions of things to come. Of course, I have my own opinions (identified when voiced below), but some of the more interesting points I have heard are discussed here, organized by the traditional real estate industry metrics (or bugaboos as the case may be).

Market Segment Roundup – Denver/Front Range

- Multifamily rental rates and occupancy are at or near peak.
- Office rents have room to increase 10% or so to peak. Suburban office is a wildcard.
- Retail rents should trend upward, with one expert predicting a 45% increase 2014-2018.
- Industrial is the best bet in terms of both growth and durability.
- Hospitality - new supply will moderate growth in rate and occupancy.

Employment/Population – An interesting confluence of trends, including rising employment, but with a soon-to-be shrinking labor force and millennials supplanting boomers as the largest population group. All in all, Denver will benefit. While many experts declare that millennials will make significantly different lifestyle choices than members of previous generations did, I believe the wants, needs and desires of millennials are not meaningfully different, but rather they have been conditioned by the world they came of age in.

Interest Rates – 10 year Treasury rates are as low as they have been since the post-World War II era. It is doubtful they will go up meaningfully anytime soon (say, 2 years), what with the government being the biggest loser if they do, but it is also really doubtful they will go down, so locking in current rates should be considered even if defeasance/yield maintenance payments are required. Maybe the attendant low cap rates and available capital will allow the market to absorb the huge debt maturities over the next three years.

Where are we in the cycle? – Near or at pre-crash valuations. Within two years of the next peak, but will that be followed by a crash? Not without some external event that overrides normal market forces.

Tax Code Changes – Republicans and Democrats will continue to use the tax code to beat each other with, but I predict nothing substantive will happen before the next Presidential election.

Other interesting tidbits:

- Average home size in the U.S. – 2,100 sq. ft.; U.K. – 800 sq. ft.; China – 650 sq. ft.
- Oil prices will remain lower near term, but will return to, say, $60 - $70 bbl within two years. $100 bbl oil will not be seen anytime soon. However, if you filter out exploration costs, oil companies can still make money for producing wells under the current pricing.
- Over the past two years 79% of REIT stock performance has been fueled by the downward trend in 10 year Treasuries, suggesting that an increase will have the opposite effect.
- Biggest threat to U.S. real estate, according to one well-regarded expert, is the decline in our educational system (which will result in a decline in our global competitive edge). The reason given for the decline is (don't shoot the messenger) …women's rights. That is, all the bright young women that used to go into teaching now have, and avail themselves of, other options.

The information in this newsletter was gleaned from a number of sources. If you have a particular question, or would like a citation to the source, please contact Zane Dennis at zane@richeymay.com or 303-721-6131.