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With Property Prices Hitting New Peaks, Where Do Brokers See Investment Opportunities?

Industry Professionals Say Emerging Markets with Population and Job Growth That Have Yet To Be Overbuilt Offer Best Value

Bryan Coggins, head of community planning firm Preface in Newport Beach, CA, has one piece of advice for commercial real estate investors in the current environment: "Sell, Now."

Even if there is some lift left in prices, Coggins said the combination of improved property values over the past several years and continued strong buyer interest make right now the time to sell. "The cost of capital has been artificially low for a long time, and that is already starting to change. So take the gains and sell now," he said.

As CoStar News has reported throughout this summer, there has been no shortage of private equity firms and REITs that have started doing just that.

At the same time, however, there is continued strong demand from buyers and a flood of capital looking to invest in commercial property.

Total sales of commercial real estate were 30% higher in the first half of 2015 compared to the same period a year ago, according to preliminary second quarter CoStar COMPs numbers. The purchase volume suggests 2015 could be another record year for commercial real estate acquisitions.

In addition, the two broadest measures of aggregate pricing for commercial properties within the CoStar Commercial Repeat Sale Indices (CCRSI)-the value-weighted U.S. Composite Index, are both up by double digits in the 12-month period ending in June 2015. The value-weighted U.S. Composite Index continues to lead the recovery and is now 13% above its prior peak, while the equal-weighted U.S. Composite Index remains 8% below its previous high-water mark in 2007.

With some U.S. regions and property types already hitting or exceeding their previous peaks in value, we asked several market experts where the investment opportunities are in today's market.

"The increase in value is primarily coming from the Class A core assets. Coming out of a recession, those are the assets that always lease up first and are in favor with investors," said Gerry Trainor, executive managing director for Transwestern based in Washington, DC. "As the economy grows and the Class A product leases up, then the Class B and C will follow suit," Trainor said. "The Class B and C product has yet to see any significant run-up in pricing, and that is where the opportunity lies."

Look beyond the core markets, as well, said others.

"Look at secondary and tertiary markets (that are) expected to have good population growth. These markets generally provide better cap rates and slightly less buyer competition," said Michael Bull, CEO of Bull Realty Inc. in Atlanta. "They certainly offer better cap rates than the gateway markets. Plus, the lack of new supply combined with the improving job market should continue to provide NOI growth opportunity."

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Bull said he particularly likes retail properties in B locations within improving housing markets. He's also long on medical office buildings, which he said provide slightly higher yields than general office, and have longer leases and less turnover.

"Aging baby boomers and Obamacare should continue to improve tenant demand" for medical office, he said.

Moderate but steady economic tailwinds have supported gains in commercial real estate occupancies and valuations, drawing strong investor interest and increased transaction velocity. Apartments were the first property type to get up off the mat and accelerate, followed by industrial and then retail and office properties. However, the uneven nature of the recovery, the unique drivers underpinning each market, and surge in overseas capital have left some markets behind in pricing trends despite solid and improving underlying drivers, according to recent analysis by Marcus & Millichap.

Although a bit slower to recover than other asset types, office performance has been though impressive price gains achieved in the past year and still trades at a 7.9% discount from its prior peak, the investment brokerage firm said.

Just back from a CCIM conference in Chicago last week, Jeffrey C. Albee, executive vice president of Sperry Van Ness - Rich Investment Real Estate Partners in Woodland Hills, CA said the topic of how to invest at a time of peak values was a major point of discussion.

"In this type of market you really need to look at statistical trends driving the demographics," specifically population growth, Albee said. "The Sunbelt is an area where see population growth due to the favorable business environment and our aging population."

But for those that don't want to change from preferred markets or property types, Albee said new ground-up development or renovations/conversions may be the way to go.

"Because we are later in the cycle, office buildings will now start to have a little bit more of the spotlight. There has been no or little speculative building in the sector," Albee said.

Regional Spotlights: Phoenix and Philadelphia

Greater Phoenix was one of the last markets to begin recovery after the Great Recession and real estate experts there say it remains one of the few major U.S. markets that is still under peak level pricing. That creates upside opportunities for investors in nearly every product type.

The market continues to see improvement in job growth and the housing market, with the anticipation of 15,000 new home permits this year which would be a 35% increase over 2014 numbers.

"There is pent up demand in Phoenix for new commercial properties. Users want Class A, functional office space with large floor plates," said Brent R. Moser, executive managing director, Land Group for DTZ in Phoenix. "They want new, flexible industrial space with large cross-docks, 36' clear heights and state-of-the-art features. They want modern, mixed-use projects that combine retail space with office, residential or hospitality uses. All of this demand has created opportunities for development."

Moser said there is also strong demand for hotel properties, given the lack of new development in the market between 2009 and 2014. With occupancy and room rates in existing properties at or near prerecession levels, developers and investors are increasingly in the market for new development sites as well as existing properties that have the potential for expansion and renovation.

In the Philadelphia market, the Lehigh Valley continues to impress. It is the state's fastest growing and third-most populated metropolitan area. The area experienced greater post-recession job growth than any of the nine major metros in Pennsylvania through 2014, said Jeff Algatt, senior vice president, brokerage-investment at Colliers International Group.

Algatt said there are still property types with room for appreciation for non-institutional investors. Specifically, he



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mentioned:

- Smaller apartments with 10 to 100 units in “walkable” communities or close-in urban areas. Many such properties are still priced appropriately with rents that have room to grow.
- Existing 50,000- to 100,000-square-foot warehouse buildings in good locations and configured to supplement the mega e-commerce distribution boxes that dominate the landscape.
- Neighborhood and community retail centers that have become demographically challenged can still be found at reasonable prices and should benefit from revitalizing locations and re-tenanting.
- Medical and health care related office facilities. Specifically, single-tenant, purpose-built offices are seen replacing older, multi-tenanted generic facilities; and suburban properties with good bones' or the ability to retrofit can offer value to investors, Algatt said.



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