

Commercial Real Estate: Looking Ahead to 2017

Description

As we enter the fourth quarter of 2016, it makes sense to look ahead at what is in store for commercial real estate in 2017. There are several factors that will impact the market in New England, and although surprises can always occur, I believe the outlook is generally positive.

First, it appears that the Fed will keep us in a low interest rate environment which means continued low cap rates on commercial real estate. Most economists expect a rate hike in 2016, but the consensus opinion seems to be that any rate increase will be limited to 25 or 50 basis points, with a similar rate increase likely in 2017. Given the continued low inflation rate, and the always precarious nature of the recovery from the Great Recession, the Fed will be hard pressed to aggressively move interest rates up from the current levels.

These low interest and cap rates have created price pressures in Boston and other top markets. It is hard to imagine prices in Boston increasing further and lowering cap rates below 4%. Rather, I would expect to see movement in other New England markets as developers move out of Boston into areas where prices have more room to grow.

A related factor is the appetite lenders have for real estate development loans. Although certain types of development (think multifamily housing) are seeing lessened interest from banks and other lenders, on the whole, competition remains strong among banks, insurance companies, and private equity funds to finance many real estate projects. For example, we have been involved in assisted living, rehabilitation, and other medical related projects in 2016, and both equity and debt are readily available to developers operating in those sectors.

An additional source of capital for real estate developers remains EB-5 money. The EB-5 program provides a method for foreign nationals investing money in the U.S. to obtain a green card by investing \$500,000 in a Targeted Employment Area (defined as an area of high unemployment or a rural area) or \$1 million outside a Targeted Employment Area. The investment must create or preserve at least ten jobs for workers in the U.S.

To date, we have seen many projects funded in part by money invested by foreign nationals. Political instability and the allure of a green card allowing permanent U.S. residency have been the major impetus behind the popularity of the EB-5 program. Many of these investors, especially in New England, are from China, Korea, and other Asian countries.

However, as political and economic instability spread through events like Brexit, it is a very real possibility that the EB-5 program may become popular with investors from the United Kingdom, and perhaps, even elsewhere in Europe. Foreign investment in American real estate has risen dramatically over the last several years, and most analysts expect that to continue in 2017.

Recent changes in American law also continue to stimulate foreign investment. The Protecting Americans from Tax Hikes Act of 2015 contained important modifications to the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA). The changes are foreign taxpayer-friendly. In particular, they reduce impediments for non-U.S. investors investing in U.S. real estate by allowing foreign investors to be treated similarly to U.S. taxpayers, which will likely lead to an increase in foreign investment in the American real estate market as well.

Unexpected political and economic events can always arise that make a mockery of any prediction concerning the real estate market. However, barring such an unexpected event, the factors discussed above should lead to a positive commercial real estate market in New England during the next year. Whatever happens, it is sure to be interesting!

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