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Future of Global Capital: Low Interest Rates, High Volatility

Global finance experts speaking at the 2016 ULI Fall Meeting in late October said institutional investors were preparing for an extended period of low interest rates and global volatility. However, U.S. presidential election results soon added another layer of complexity to the forecasts. "The prevailing view is everything is fully priced and nothing is particularly cheap," said Jack Chandler, managing director of global real estate firm BlackRock, during a panel on the future of global capitalization. Jon Zehner, cohead of LaSalle Investment Management's client capital group, told the group that most investors were assuming that interest rates would rise slowly, if at all, over the next few years. He revised those remarks after the election. "The unanticipated U.S. election results have clearly changed the markets' expectations around U.S. government spending and tax policy, with many investors anticipating that a President Trump will dramatically increase infrastructure spending and request significant tax cuts," Zehner said. "The combination seems likely to produce wider government deficits and consequently, over time, inflation above current levels. This should prompt a rise in interest rates, which we are already beginning to see in the bond markets and changes the intermediate-term view that interest rates will stay low for longer. Although it is too early to tell what the impact will be on real estate asset pricing, it may well alter the value of asset income streams and dividend yields, as I had articulated on the ULI Dallas capital markets panel discussion." Balancing risk with the demand for yield is becoming an increasingly difficult equation, the panel of high-level investment executives emphasized in the discussion moderated by Ngee Huat Seek, chairman of Global Logistics Properties and chairman of ULI Asia Pacific. Uncertainty about central bank policies on interest rates continues to affect the value of risk assets and the amount of liquidity, Chandler said. Investors are "spending as much time trying to handicap [central banks] as property markets," he said. Three things are guiding the current market, Zehner said at the Fall Meeting: leverage levels are coming down, lenders are demanding more control, and the pace of international capital investing around the world has gone up "dramatically." In turbulent times, with investors hunting for yield, "clearly, real estate is in favor these days," said Peter Ballon, head of real estate investments for CPP Investment Board. "Large pools of capital continue to exert buying power" around the globe, he said, with the appetite for property still strong from Asia and the Middle East. "These pools of capital are not going to be very spooked by interest rate movement," Ballon said. "This is permanent capital committed to real estate, and they will provide some stabilization to pricing that will be good for real estate in the long run." More investors are looking at real estate as a long-term commitment, not a short-term trade, said Michael Spies, senior managing director, Tishman Speyer. A recent ULI study of institutional investors found that 20 percent of assets were held for more than 20 years, he said. "I suspect that number will grow." Recent data show that the international flow of capital into real estate is still growing, with alternative investments offering few rewards with similar risks, panelists said. Global investors still need a place to put their money, even when rates are low. Geopolitical risk is driving investors to real estate, not slowing them down, Zehner said. "A lot of capital flowing into real estate is just looking for a safe haven," he said. Despite high valuations, many of the global funds will continue to focus on top-quality locations, not secondary markets, he said. "People still remember [the crash]," he said. Funds around the world are adjusting their allocations toward real estate, even though projected returns may be lower than in the past, panelists said. "Astonishingly, making 4 or 5 percent income yield, having some inflation hedge and some prospect for capitalization preservation and maybe some

growth, actually ends up being fairly attractive," Chandler said. "The whole metrics are being challenged by these low rates." These days, "in true core," 6 percent is an acceptable total return," Spies said. The real risk is "people stretching the definition of core to chase yield," he said. Developing markets are "where the growth is," Spies said. His fund is looking more to emerging markets that have been hammered in recent years, including Brazil. "Brazil looks like a pretty opportune time," he said. After an era of turmoil, there is the "beginning of a shift in sentiment, so now is the right time to be investing cyclically in Brazil," he said. CPP Investment Board is also looking for higher yields in noncore markets, Ballon said. The company is "pulling back from trophy real estate," he said. In top-property markets like midtown Manhattan, "the pricing in our mind is very expensive," he said. Instead, CPP is focusing more on markets with "dislocations," where there are higher risks but more opportunity for higher returns. Recent investments include office buildings in Calgary, Canada, which has been hit by the oil downturn; China; the United Kingdom; and Brazil. "We're trying to work around the edges," Ballon said. "We're going into new sectors." But this is a playing field requiring expertise and "feet on the ground" to succeed, he emphasized. "Anybody who invests without that will get what they deserve," he said. Many geopolitical factors—including instability in China and continued turmoil in Europe—loom on the horizon. The fallout from Brexit is still largely unknown. In the short term, there has been little impact, said Zehner, who is based in London. "If you talk to real estate owners in London, in terms of their rental experience, it has been largely a nonevent," Zehner said. Prices are pretty much unchanged, though a little softer, he said. But the long-term impact is much more difficult to predict. "What is in the background is we still have no idea what Brexit will mean, and the level of uncertainty." The Brexit story is only starting to play out, panelists agreed. "The fact is, two years from today we will not know anything more," Spies said. "The whole way this thing unfolds unfortunately just creates uncertainty." Whatever the outcome "it will be expensive" for Britain, he added. **(ULI)**

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Metro Denver Rents Fall for Third Month in a Row

If three months in a row qualifies as a trend, then metro Denver's rent increases are softening again. Metro Denver apartment rents averaged $1,381 in October, down from $1,394 in September, $1,408 in August and $1,412 in July, according to Axiometrics. Effective rents, which adjust for landlord discounts, are rising 1.8 percent on an annual basis in metro Denver, below the 2.6 percent pace seen nationally, according to Axiometrics. Two years ago and into the summer of 2015, apartment rents were rising at a double-digit annual pace in metro Denver. While that wasn't sustainable, rent increases in Denver have run below the U.S. average since August and are trending below the 3 percent pace of consumer inflation measured in the first half of the year in the Denver-Boulder-Greeley area. A large number of new apartments are hitting the market and job growth is slowing, which is tempering rent hikes, said Stephanie McCleskey, vice president of research at Dallas-based Axiometrics. "Job growth is still pretty good compared to the national average, but it used to be stronger," she said. "Job growth and rent growth are highly correlated." Even with slower job growth, metro Denver isn't adding too many apartments and single-family homes. Rather, the issue is that so many of the new apartments are coming in a very concentrated area and marketed as "luxury" units. Metro Denver should add 7,000 apartments this year with another 10,000 slated to become available in 2017. Of

those, 4,000 are coming in just one sub-market, downtown Denver, McCleskey said. New downtown Denver apartment rents are averaging $1,851 a month, a premium of 34 percent or $470 a month over the metro average, according to Axiometrics. Currently, metro Denver landlords are trying to fill 5,400 apartments, and all that supply is forcing landlords of the newest buildings to cut some deals. Owners of downtown Denver’s newest apartments are offering concessions worth $70 a month as they try to fill their buildings, 10 times what the owners of downtown’s older buildings are offering, McCleskey said. Across metro Denver, landlord concessions run about $5 a month versus $8 a month nationally. If month-over-month declines in rent continue long enough, then the annual change in rents, now positive, will eventually turn negative. But McCleskey doesn’t see that happening. Axiometrics forecasts metro Denver apartment rents will increase 2.5 percent next year. **(Denver Post)**

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Colorado Gains 6,000 Jobs; Unemployment Edges Down to 3.5%

Colorado employers added 6,000 payroll jobs in October, and the state's unemployment rate edged down a tenth of a point from the previous month, to 3.5 percent, the Colorado Department of Labor and Employment reported Friday. The state's private-sector employers added 6,900 jobs last month, while public-sector jobs declined by 900, CDLE said. The gain of 6,000 payroll jobs in Colorado was ahead of the state's 12-month average monthly gain of 5,342 jobs over the last 12 months. Colorado now has 2,626,800 payroll jobs, up by 64,100 from October 2015. And that puts the state on-track to close out the year with about a 2 percent annual growth rate, said Alexandra Hall, the state's chief economist. "The October numbers really continue to tell the story we've been seeing all year long — with a caveat that the unemployment rate has gone up or down a point — but we are in the same spot as one year ago," she said. The labor market is tight in nearly every county. Only one county, Huerfano, has an unemployment rate above 5 percent. Colorado's largest month-to-month private-sector job gains in October were in education and health services, trade, transportation, and utilities, and leisure and hospitality. The largest over-the-month declines were in manufacturing. Over the last year, the biggest Colorado job gains in the private sector have been in construction, leisure and hospitality, and education and health services, while mining (including energy production jobs) and logging, manufacturing, and financial activities declined over the year. But Hall said there was not a big jump in the job losses in the oil and gas sector. "The big downturn in that area is behind us and we have weathered it pretty well," she said. Since October 2015, the average workweek for non-farm payroll workers in Colorado has risen to 34.3 hours a week from 33.9 hours a year ago, and average pay has increased 20 cents an hour to $27.27, CDLE reported. Those payroll-job numbers come from a survey of employers and do not include farm workers or those who work for themselves. A separate survey of households -- the survey used to estimate unemployment -- shows that the number of Coloradans reporting themselves as employed -- including farm labor and the self employed -- increased 15,000 in October to 2,808,500. And the state's labor force -- defined as employed people plus unemployed people actively seeking a job -- rose by 11,200 in October. Colorado's estimated unemployment rate of 3.5 percent last month was well below the national rate of 4.9 percent. It was the second straight monthly decline in the state's jobless rate, from 3.6 percent in September and 3.8 percent in both July and August.

Colorado's unemployment rate hit a post-Great Recession low of 2.9 percent in March. The state's recession-period unemployment peak was 8.9 percent in September and October 2010, based on recently revised estimates. Government unemployment figures do not include people without a job who are not seeking work for whatever reason; they are not counted as part of the labor force. **(Denver Business Journal)**

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	CURRENT	1 MONTH PRIOR	1 YEAR PRIOR
FED TARGET RATE	.50	.50	.25
3 MONTH LIBOR	.91	.88	.37
PRIME RATE	3.50	3.50	3.25
10 YEAR TREASURY	2.34	1.75	2.26
30 YEAR TREASURY	3.01	2.51	3.01