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FIRPTA Changes Herald Increased Real Estate Investment Funding

In a previous column I discussed how money from overseas is having a powerful impact on the availability of funding for new development here in the U.S., and is extending the nation's economic recovery. Now, thanks to new legislation signed into law in December, the large amounts of funds that foreign investors are already investing in U.S. real estate development is likely to increase. The Protecting Americans from Tax Hikes Act of 2015 (PATH, for short) wards off potential tax increases when various tax cuts are sunsetted. But in addition to impacting Americans, the act eases the ability of foreigners to invest in U.S. development via changes to the Foreign Investment in Real Property Tax Act (FIRPTA). Before getting into the specifics of the changes, let's put this into context. The new legislation changes some 35 years of provisions that limited foreign capital flows into this country and specifically into real estate. In those days, it was perhaps due to concern about overseas control of American properties, but today international transactions and investments are the norm, financing availability is paramount and "paper ownership" of real estate is moot. Today, such international sources as government treasuries (i.e., sovereign wealth funds), high net-worth individuals and global companies with their own pension funds are eagerly seeking out American real estate deals. These sources of money are primarily seeking safety in the U.S. market. The impact on real estate development is that there has been plenty of money to fund decent deals. Enter FIRPTA reform, which promises to increase this flow of funds into U.S. real estate development. Let's examine a few of its details, laid out in a recent PwC "Real Estate Tax Alert." First, it doubles, from 5 percent to 10 percent, the percentage of publicly traded stock a foreign shareholder may hold without incurring FIRPTA withholding and tax upon sale of the stock. It also exempts certain gains on the sale of REIT stocks and capital gain distributions from REITs, both broadening the possibility for greater foreign investment in U.S. public REITs. The act also exempts foreign pension funds from FIRPTA tax and withholding. This new exemption applies both to a foreign pension fund's disposition of the U.S. real property interest and capital gain distributions from REITs. This exemption further applies in the case where a foreign pension fund indirectly holds a U.S. real property interest ("USRPI") through a partnership interest. Removing this tax barrier should provide additional motivation for foreign pension funds to invest in U.S. real estate. Also, under the current law, gains on shares in a Regulated Investment Company ("RIC") that holds predominantly U.S. real property is subject to the FIRPTA tax regime when recognized by a non-U.S. person. Now, the law permanently extends the qualification of RICs to be qualified investment entities as defined for this purpose. This would exempt the gain on sale of RIC shares from the FIRPTA withholding and tax, again further incentivizing foreign investments in U.S. real property. Yes, the law does include an increase in the rate of FIRPTA withholding on USRPI dispositions, from 10 percent to 15 percent, but this withholding would generally offset any tax due from the non-U.S. shareholder upon filing of a U.S. tax return. The bottom line is this: Times have changed, and foreign capital flowing into U.S. development is, overall, a good thing. Direct ownership of buildings in major markets will be most directly impacted, with safety—not yield—as the primary motivation of foreign investors. Those investors not willing to accept minimum returns in major markets may invest in secondary U.S. cities. Overall, the changes will likely enhance the movement of capital from East to West, detailed in PwC's Global Emerging Trends in Real Estate 2015, published in partnership with the Urban Land Institute. True, capital flows are driving prices higher in certain large metro markets, and my guess is they will go higher. But overall, we currently don't have enough development to

address supply needs, including infrastructure. I expect the changes to FIRPTA to aid greatly in funding these new projects, and their positive impact on continuing real estate investment opportunities. **(National Real Estate Investor/Byron Carlock)**

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Unico Adds to Platte St. Holdings

Unico Properties bought the Monkey Barrel bar at 1615 Platte St. for $2 million last week. The Seattle-based real estate firm is pitching a four-story development that will replace the bar and continue a wave of new development on Platte. Plans submitted to the city, not yet approved, show about 82,000 square feet of office space, 6,600 square feet of restaurant space and 2,500 square feet of retail space. The latest site plan came in March 3. In a Tuesday phone call Ned Carner, Unico's vice president for acquisitions, said demolition is scheduled to start in July and the building will break ground even without firm leases inked. Unico, through a public relations representative, declined any further comment. The office space will be in the top three floors, with retail stalls at ground level facing Platte Street. There are two retail strips separated by a building lobby. The larger of the two, marked as the restaurant space, is on the building's west side nearer to 16th Street and the Highlands pedestrian bridge. Plans show three floors of underground parking and about 150 spaces. Open Studio Architecture, the same firm that designed The Lab next door and the Galvanize 2.0 building across the street, is the architect listed on Unico's site plans. The Monkey Barrel site is the last bit of a three-piece land assemblage Unico has put together for the Platte Street development. Unico paid $500,000 for 0.40 acres of vacant land around the bar in March 2014. The company added a small brick building just east of the Monkey Barrel for $900,000 a month later. Unico has not been active in Denver development in recent years, but the company has pumped plenty of money into the city's real estate market. Since January 2015, Unico has bought an office building at 1430 Wynkoop St., the Denver Club building on 17th Street, a cluster of Cherry Creek buildings at Second and Josephine, and the Elephant Corral building on Wazee Street. Those acquisitions totaled more than $115 million. Meanwhile, the Monkey Barrel is leaving Platte Street for Sunnyside. Owner Jimmy Nigg has leased a new space at 4401 Tejon St., with plans to reopen the Monkey Barrel in the second quarter. Monkey Barrel isn't the only business swinging off of Platte Street as development reaches a fever pitch. Empire Staple Co. sold its building down the street last month to developer Trammell Crow Co. Empire Staple moved its operation to Adams County and Trammell Crow is redeveloping its former Platte Street headquarters. Unico has more real estate to work with on Platte Street. The company spent $24.59 million to buy up nearly the entire 1500 block of Platte Street in March 2014, city records show. That package included about 96,000 square feet of leasable space between the Root building at 15th and Platte, and the Zang building at 1553 Platte St. Aside from a small, 0.20-acre parcel at 1537 Platte St., Unico owns the entire north side of Platte Street from 15th Street to the Denver Beer Co. **(BusinessDen)**

Get Ready for Liquidity Crunch in Late 2016?

We dive into what is causing the choppiness in the CMBS markets, and alternatives where borrowers are heading to refinance pending loan maturities. As well, we consider how these events could affect the capital markets in the second half of 2016. CMBS issuance year-to-date, as of March 10, has been a paltry $12.4 billion, compared to $27.0 billion for the same time period in 2015. Given the robust (or at least steady) flow of positive national economic employment and spending figures, we ask—why are CMBS originators pumping the brakes? Unlike the last cycle, in which lax underwriting precipitated the initial slowdown in the CMBS market, in this case there are various external factors that are making it hard for CMBS lenders to price new loans competitively and commit to terms prior to closing. First, the number of CMBS lenders has shrunk. As spreads continued to widen through fourth quarter 2015, various players missed their break-evens in the December 2015 securitizations and were pushed out of the market. The insight from our recent survey of CMBS lenders is that the market will "barbell" as mid-sized origination shops are squeezed out by large originators that are securitizing on a frequent basis and niche lenders that are bound to specific product types or geographies. The focus now is on execution, after a volatile fourth quarter in which the spread on benchmark CMBS paper blew out, squeezing profits and causing higher spreads on new loans. Second, CMBS bond buyers are still finding their feet in the new year. Spreads for the "rated" tranches of recent CMBS securitizations are being pushed wider as these bond buyers look to the relative value of widened spreads on corporate bonds and demand the same (or higher) returns from CMBS bonds. Had this just been typical "noise" in the market, CMBS spreads would have pinched back in or stabilized at a wider spread, but in this case the pending regulatory requirements (set to take effect in December 2016) for the "unrated" B-piece of the CMBS securitizations is leading to a greater uncertainty in nascent business model of CMBS 2.0, as CMBS originators and private funds reconfigure the capital used for B-piece purchases. The new regulations will require CMBS originators to keep a stake in their originations and hold the risk on their balance sheets for five years in an attempt to discourage risky lending and keep their "skin in the game." As a result, CMBS originators are treading cautiously—pricing loans with enough "cushion" and regressing to primary markets. Subtle innovations include a "spread lock" mechanism for large loan borrowers, as well as lenders raising capital to acquire their own "unrated" B-piece tranches in separate vehicles. Borrowers who would traditionally look to a CMBS refinance are looking elsewhere, as re-trades on pricing and terms in the turmoil of the year end have now readjusted their expectations on leverage and focus on certainty of execution. Dekel Capital recently conducted a comprehensive survey of the banks, debt funds and life companies that are soaking up the pending loan maturities that one year ago would have gone to CMBS. Market sentiment is positive as debt funds are seeing more business as borrowers look for better execution and/or 36 months of runway to decide to either sell the product or place fixed-rate pricing on it. Additionally, there are life companies with products pushing leverage to 70 percent loan-to-value (LTV). These newer products can rate lock at application and are priced competitively against CMBS. Market input is that the 2016 lending capacity for debt funds, life companies, and banks may be deployed by later summer, leading to a potential liquidity crunch should deals come up against a pending loan maturity. The equity groups we speak with on a regular basis have echoed this sentiment, modeling their own exit scenarios and shifting away from investing in vacant office conversions or retail repositions involving a significant period of downtime, with the focus on in-place cash flow. **(National Real Estate Investor/Shlomi Ronen)**

Is Denver's Industrial Real Estate Market a Sleeping Giant?

Industrial space in metro Denver is costlier and harder to find than ever, but before you blame the area's sustained record highs in average lease rates and spare vacancies on marijuana — don't. Pot businesses need space to grow, but their overall stock in the industrial inventory in Denver is still minimal. 2015 research from commercial real estate firm CBRE Group Inc. shows that pot cultivation accounts for only about 2.6 percent of the existing warehouse footprint. There are actually much bigger trends driving the numbers. The real reason the industrial sector hit record-low vacancies a few quarters back and bobbed around 4 percent for over a year? An influx of food manufacturers needing warehouse space, retailers creating distribution hubs and advanced manufacturing companies looking places to build groundbreaking new technology. All this activity has resulted in a 17 percent year-over-year increase in the average rent charged for industrial space in metro Denver, which has spurred plenty of new construction - 2.6 million square feet as of the end of 2015. The vast majority of that construction - 99 percent — is happening in the northeast and Montbello submarkets. The amount of construction happening now represents an 18 percent increase over the amount of construction underway at the end of 2014, when 2.2 million square feet were under construction. It's a good thing, too, according to industrial brokers in the city. A lack of industrial space can hurt economic development efforts. But new, large-format industrial construction is keeping Denver from falling victim to that, said Jim Bolt, first vice president at CBRE Group Inc. "From a broker's standpoint, it hasn't hurt us yet," he said. "It's tight, but it's not that tight yet." But Tom Clark, CEO of the Metro Denver Economic Development Commission, said that keeping the industrial pipeline working takes constant communication between his organization and developers. "We try to stimulate speculative space," he said. "We let developers know what's needed. It's a continuous conversation." Denver's commercial real estate has changed form and geographic concentration to better suit the needs of businesses. Retail areas have morphed from downtown hubs to enclosed malls and back to indoor-outdoor lifestyle centers, and office buildings have pushed beyond the central business district to fill the Denver Tech Center and bring daytime activity to suburbs that were once bedroom communities. Industrial space — while lesser-noticed segment of the commercial real estate industry — is no different. Overall, sizes of industrial space have grown, the buildings are taller, and they're distributed differently across the metro area to reflect changes in transportation capabilities over the years. Decades ago, industrial space was clustered around rivers in central parts of the city, like River North and the Central Platte Valley. Milling, mining and ranching were the city's big industries, and what passed for industrial space was a far cry from what it is today. Buildings now are bigger, taller and employ more sophisticated technologies to keep products safe and help companies do business. And Denver's industrial core has shifted and expanded as the city has grown, from a corridor along Interstate 25 between U.S. 6 and Interstate 70 to a metro-wide network that reaches to every corner of the area but has an especially heavy concentration in the east. As the city began its march toward modernity in the 1970s, so did the industrial stock. "Warehouses were a lot smaller than they are today," Bolt said. In the 1970s, Bolt said, industrial buildings ranged in size from 10,000 to 20,000 square feet and were around 21 feet tall. But the city's small industrial beginnings got a jolt in a serious way, thanks to a commitment from a luggage company and the real estate developers that would build its home. In 1966, Chicago-based real estate company Bennett & Kahnweiler entered the Colorado market and began work on Denver's first major industrial development, Montbello, which still stands as Denver's biggest industrial submarket. Over

the course of the 1970s, the company built more than 71 buildings including 4 million square feet of industrial space in Montbello Industrial Park. The park featured a major economic development score for Denver in the form of a new Samsonite headquarters campus. Before Montbello, Bolt said, "Denver's industrial market was a fraction of what it is now. Samsonite was the first big user. It was a huge catalyst." Today, Montbello is listed as its own submarket on industrial reports from every major commercial real estate brokerage in the city. The area had more than 71.7 million square feet of space in 1,032 buildings at the end of 2015, according to research compiled by Colliers International. After Samsonite took the plunge and Bennett & Kahnweiler accommodated, more developers entered the picture, Bolt said. Buildings grew slightly, to about 30,000 square feet on average and 24 feet tall in the 1980s as Colorado's population grew and development began spreading out along I-70, growing east toward Stapleton Airport, said Murray Platt, also first vice president at CBRE Group. But economic troubles that hit both the nation and metro Denver in the mid-1980s put a stop to all that momentum, Platt said, with no substantial new product being built in metro Denver from 1985 to 1993. The entire Denver real estate market suffered in the 1980s as energy businesses contracted, with office space downtown sitting empty and new construction drying up. The industrial segment gave back to the market some 2 million square feet of space in 1985 and 1989, according to historic data from CBRE, with varying amounts of negative absorption occurring between those two years. Positive absorption finally made its way back in the new decade, with more than 2 million square taken up in 1990. The trend of positive absorption has continued every year in Denver since then, with three exceptions: 1996, 2001 and 2009, according to CBRE's data. Once the market made that recovery, Bolt said, it continued its march east, with areas like Stapleton and Montbello becoming favored by industrial giants like Prologis and Majestic Realty Co. Again, developers started building taller, with heights reaching 28 feet, and new sprinkler system technology arrived on the scene, Bolt said. Taller buildings themselves are a sign of new technology in the industrial world, as higher ceilings are indicative of advances in stacking and storage that allow companies to keep more product in a smaller amount of space. A major shift in the landscape of eastern Denver occurred in 1995 with the construction and opening of Denver International Airport, further driving development in that direction, Bolt said. The Pauls Corp. purchased 1,000 acres around the intersection of Peña Boulevard and Interstate 70 that would become Gateway Park, a mixed-use project that is still seeing development today. Building bigger and further east remained the trend through the first part of the new century and into today as Denver increasingly becomes an important distribution hub and a popular place for manufacturing jobs."Users are distributing to bigger and bigger areas from their warehouses," Bolt said, which increases the need for industrial space, and Denver's combination of a large airport and central location makes it a draw for companies that want to get their products to the midwest and mountain west. Along I-70, east of I-25 and all the way to Aurora and beyond, large-format industrial space with flexible, generic floorplates and tall ceilings reign supreme, with new development of that nature announced every few months as distributors and manufacturers gobble up existing space and marijuana growers take up smaller spaces, pushing out other companies. Prologis, for example, will soon have 4 million square feet of industrial space in Stapleton, said Wayne Barrett, Denver market officer for the company."Tenants are doing more regional distribution," Barrett said. "Distributors have gotten bigger." Prologis has been on a building spree in the eastern part of Denver, constructing several speculative buildings that lease up often before construction is even complete. Namely, the company's Stapleton Business Center North, a 261,000-square-foot project that was fully leased weeks before construction wrapped on the development. While

east Denver and areas around DIA remain popular sites for industrial development by large companies such as Prologis and United Properties, other developers that don't own coveted land in those submarkets have had to get more creative in order to build the industrial space the Denver market wants. Trammell Crow Co., for instance, has a long history in Denver industrial real estate, but Bill Mosher, the company's senior managing director here, had to go hunting when he wanted to build industrial space. Denver was the second office opened by Trammell Crow - the person, not the company - when he got started decades ago. Crow had an office in Dallas, but Denver was his second play and he got to work building industrial here featuring a tilt-up wall technique that was new to the industry at the time, in 1958. Tilt-up construction involves the formation of concrete elements on a horizontal slab that are then tilted into the vertical position. The practice can save time and money in construction. Even with those deep roots, Trammell Crow - the company, not the person - didn't have a large chunk of land available in Denver suitable for the large industrial park it wanted to build."We're active, but we're not traditionally long-term landowners," Mosher said. He originally went looking for a piece of land along the I-25 corridor south of I-70, but instead ended up with 77 acres just north of I-70 at a site formerly inhabited by Asarco, a smelter. The land where the Asarco Globe plant operated was in need of environmental cleanup, but Trammell Crow decided nonetheless to build nearly 1 million square feet of industrial space there. The site came complete with the odd configurations that are often characteristic of infill sites, but had good access to both interstates and was about as centrally located as it could be, Mosher said. His company sold the first build-to-suit building on what is now called Crossroads Commerce Park to Empire Staple Co. in late February. While buildings have gotten bigger and taller, Mosher said, industrial buildings are also better neighbors than they used to be. Industrial properties used to conjure up images of loud, smelly buildings that spewed noxious fumes and were far from kid-friendly. But today, not only are operations inside the buildings cleaner, the properties are increasingly serving as offices to companies, which adds an element of livability to new developments. Also bucking the "build it east" trend is Etkin Johnson Real Estate Partners, which entered the industrial scene in Denver after the 1980s recession. The company is one of few building industrial product in the western portion of the metro area with its Colorado Technology Center in Louisville. In December, Etkin Johnson broke ground on its latest building, a 128,581-square-foot speculative project, in the business park near the intersection of Highway 287 and Northwest Parkway."We found our niche not competing with other developers along I-70 and taking advantage of the record demand for industrial space in Boulder County," said Ryan Good, executive vice president and partner at Etkin Johnson. The Boulder submarket has just over 5.2 million square feet of industrial space, with a vacancy rate of 3.9 percent, according to Colliers research. But the average lease rate for space there is the most telling indicator of demand in the area. Industrial space in Boulder in the fourth quarter of 2015 was being leased for an average rate of $13.55 per square foot, triple-net, according to Colliers. By contrast, the market average in the same period at $7.81 per square foot. Etkin Johnson assembled the land over 15 years, Good said, and has an option on up to 33 more acres for further development. Colorado Technology Center's proximity to Boulder means that tenants there tend toward high-tech, research and development and food manufacturing, Good said. **(Denver Business Journal)**

	CURRENT	1 MONTH PRIOR	1 YEAR PRIOR
FED TARGET RATE	.50	.50	.25
3 MONTH LIBOR	.64	.62	.27
PRIME RATE	3.50	3.50	3.25
10 YEAR TREASURY	1.98	1.67	2.12
30 YEAR TREASURY	2.75	2.49	2.70