

# Real Estate Market Update from CBRE's Perspective

## LAI Baltimore Chapter – May 2015 meeting

CBRE is one of the largest commercial real estate service companies in the world with a broad platform including sales brokerage, finance, property management, appraisal, loan servicing and development services all within one company. Although headquartered in Los Angeles, CBRE's Baltimore office has a long, successful tenure in the Mid-Atlantic which has been primarily involved in multifamily and industrial sales and finance. On May 20, 2015, the Baltimore Chapter of LAI was pleased to have two of CBRE's top executives visit with us to provide an update on the multifamily and industrial markets.

Bill Roohan is a multifamily sales specialist who has undoubtedly brokered the sale of more apartment projects than any other individual in the Mid-Atlantic region. Bill provided an update on the state of the Mid-Atlantic market from his well-informed perspective.

Bill began by reminding the group how far multifamily projects have come in the Baltimore market, from the initial redevelopments of old warehouse/loft buildings in the 1980's (like the Sailcloth Factory and Greenhouse Apartments) to the recent sale of Bozzuto's Union Wharf project, which smashed all previous sales records by trading at a remarkable \$432,000/unit earlier in 2015. The Union Wharf sale was at a sub-6% IRR on an all cash basis, which signifies that Baltimore has been discovered by institutional investors as a desirable market in which to invest. Bill characterized Baltimore as a "Steady Eddie" market for apartments with sales and absorption of new projects all proceeding in an orderly, "as-expected" manner to date. With approximately 7,000 units in various stages of development within Baltimore, the steady absorption of apartments may yet be tested by an overhang of supply. Bill opined that the recent riots in April will only have a minor impact on the absorption of Baltimore's current apartment pipeline. He believes that the secular trend of younger adults wanting to live in urban, downtown environments will continue. He sees the Millennial Generation continuing to push significant life events (i.e. marriage and home buying) out into their 30's, as opposed to the tendency of earlier generations to marry and buy homes in their early 20's.

Bill advised that there remains very robust demand from potential buyers of apartments. He cited a substantial pool of buyers. Bill opined that this strong demand makes a "small, quiet" sale offering for multifamily assets unnecessary, adding that there is huge demand for all classes of apartments (Class A, B and C).

Bill also provided an overview of recent dynamics within the apartment finance industry as follows:

- Fannie Mae and Freddie Mac are still the primary capital sources for apartment finance however, their regulator (FHFA) has recently capped their annual loan volume at \$30 billion each (FHFA has exempted "affordable" apartments whose rents do not exceed 60% of AMI such that the effective cap may be closer to \$40B during 2015). Since they were on track to do substantially more volume than this cap, there could be a dearth of capital available for apartment finance in the second half of 2015.
- CMBS lenders are attempting to fill the void created by FHFA's cap imposition on the GSE's, but borrowers can't lock their interest rate on a CMBS loan until just before closing, which is problematic for borrowers. CMBS lenders will routinely finance 70 – 80% LTV, so borrowers can

still achieve leverage levels similar to a GSE financing, except that you cannot place a supplemental/second mortgage on a CMBS loan, which one can do on a GSE loan.

- At approximately 65% LTV, banks and life insurance companies are viable options for apartment buyers who do not need maximum leverage. However, it is now increasingly difficult for borrowers who need 70% leverage to fulfill their borrowing needs with Fannie/Freddie forced to pull back.

Robert “Bo” Cashman followed Mr. Roohan’s presentation, with a focus on the industrial and office markets within the Mid-Atlantic region. Mr. Cashman began with the surprising statement that 95% of all office & industrial buyers are purchasing assets on an all-cash basis, without any financing. Bo advised that essentially all investors in the office/industrial market are focused on unleveraged returns. Typical buyers include private REITS and private equity funds, who raise substantial sums for opportunistic RE investments. Examples given were Exeter Property Group, TA Realty and Industrial Income Trust. These highly liquid buyers are very desirous of acquisitions within the Baltimore-Washington corridor and are willing to lower their offered cap rates by approximately 25 bps in order to acquire well located properties within the corridor.

Regarding industrial properties, cap rates rose to roughly 10% during the early years of the Great Recession. But with the increased perceived desirability of industrial assets coupled with increased liquidity flowing into this segment of the RE market, at present cap rates for industrial have dropped into the 5.0 to 5.5% range. And sales volumes have increased substantially. Whereas in a “normal” year industrial sales volume would average around \$500 million, close to \$1B in sales were closed in Mid-Atlantic in 2014.

Trends evident within the industrial market include:

- Vacancies are moving down in general.
- Cap rates will continue to decline as a lack of zoned land and new SWM regulations limit the viability of new construction.
- Further depressing new supply is the fact that industrial rents do not support the current cost of new construction (at \$100 to \$110/SF).
- “E-Commerce” facilities demand is increasing (these are large 700,000 – 1M SF warehouses designed to allow ease of distribution for the likes of Amazon and other suppliers of goods purchased via the internet).
- 36’ clear ceiling height is the current standard for desirable industrial buildings, however 42’ ceiling heights are becoming available within the Mid-Atlantic. E-commerce users are contributing to this trend by stacking products higher and “going vertical more than horizontal”.

With respect to the office market, Bo advised that the sale of the Thames Street Wharf building at 1300 Thames Street in 2014 set the new high water mark for office values in Baltimore, trading at a whopping \$341/SF. The previous record was set by the sale of 100 E Pratt Street which sold for \$316/SF. Interestingly, all four of the “best & final” round of buyers were foreign buyers, including German, Kuwaiti and Israeli bidders. Bo opined that “liquidity risk” (the risk that a building might not re-sell at favorable pricing due to liquidity drying up in the future), prevents many institutional buyers from looking actively in Baltimore and similar “secondary” office markets. Notwithstanding that trend, there were

over 24 investors expressing serious interest in Thames Street Wharf. There appears to be plenty of liquidity chasing office assets in these increasing frothy times.

After a lively Q & A session, the attendees thanked Messrs. Cashman and Roohan for a most informative RE market update!