SEYFARTH SHAW

2018 | Real Estate Market Sentiment Survey

Executive Summary

The first year of the Trump Administration is in the books, and with it came a new tax bill passed into law and soaring stock market records. As the economy continues to show signs of growth in 2018, commercial real estate executives cite rising interest rates once again as their lead concern for the industry this year, according to Seyfarth Shaw's 3rd annual Real Estate Market Sentiment Survey.

Hawkish on Hikes

Consistent with last year's sentiment, respondents are overwhelmingly hawkish: 98 percent expect interest rate increases from the Federal Reserve in 2018, with one third of real estate executives projecting three increases over the next 12 months. As the real estate industry embraces the new Trump tax cuts, low unemployment and stock market success, industry insiders expect today's economic factors to force the hand of the new Fed Chair and, consequently, shape their 2018 investment strategies.

From new tax policy to the rise of ride-sharing, Seyfarth Shaw's 2018 Survey examines the industry's current market sentiment:

Pain Point: Respondents clearly believe that multiple interest rate increases will start to have a material adverse impact on the commercial real estate market. With large questions looming on the federal deficit and budget, 63 percent of commercial real estate executives believe the industry can stomach an increase of 51-150 basis points.

Fundamental Focus: As a new sheriff takes charge at the Fed, respondents continue to focus on the fundamentals, ranking rising interest rates and CRE supply/demand issues as their top concerns for the industry. Notably, political volatility is a sizable concern while concerns over banking regulations fell and concerns over a wall of maturing CMBS loans appear past their peak.

Trump Tax Turbocharge: Last year, survey respondents placed tax reform near the top of the heap when it came to the Trump Administration's expected positive impacts on real estate. Now that this has become a reality, most respondents (58 percent) believe that the new Tax Cuts and Jobs Act will extend the positive industry cycle for at least another one to two years – right into the 2020 presidential election.

Rise of Ride-Sharing: 43 percent of respondents believe the rise of ride-sharing services will impact their analysis and/or development of property. Due to the efficiency and growing popularity of ride-sharing services, real estate executives are increasingly re-evaluating their properties based on reduced parking needs and proximity to public transportation.

Web Worries: A credit to the ongoing efforts of the FBI and Homeland Security, cyberattacks have not yet profoundly hit the real estate industry. Despite this, a significant number of survey respondents (46 percent) remain concerned about a cyberattack in 2018 affecting their businesses.

Bearish on Bitcoin: Although a popular topic at water coolers across the country, a vast majority of respondents (96 percent) report they have no plans to adopt cryptocurrency into their CRE transactions in 2018. Three big reasons why: volatility, lack of understanding, and lack of regulations.

Private Equity Push: With more third party investment expected this year than 2017, private equity and institutional investors are the top primary sources of equity for respondents in 2018. Jumping from No. 3 to No. 1 this year, private equity is viewed as the preferred source due to its new tax benefits and the current positive economic conditions.

Long and Winding Road: Most survey respondents (73 percent) report that infrastructure will not be a part of their investment strategy. Although not released at the time of the survey, the Administration's new infrastructure bill places a hefty burden on cities – a potential cause of concern for real estate executives.

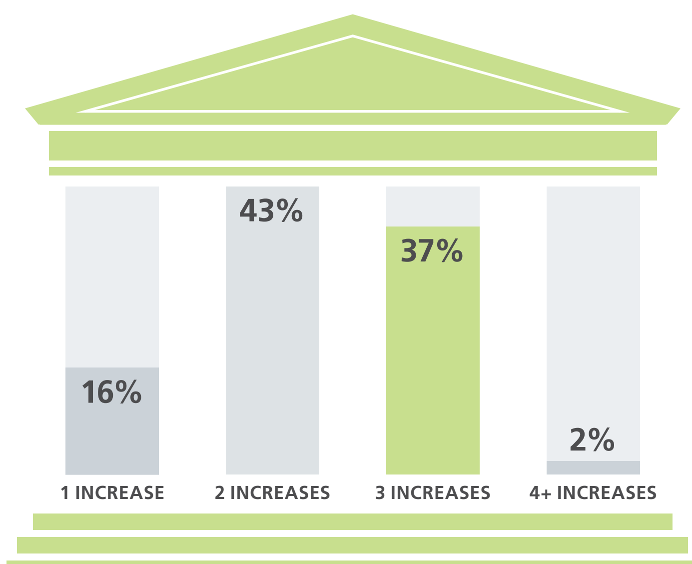
Q1: How many interest rate increases do you expect from the Federal Reserve in 2018?

Hawkish: At least one rate increase

With strong certainty, **98 percent** of respondents believe the Federal Reserve will raise interest rates at least once in 2018.

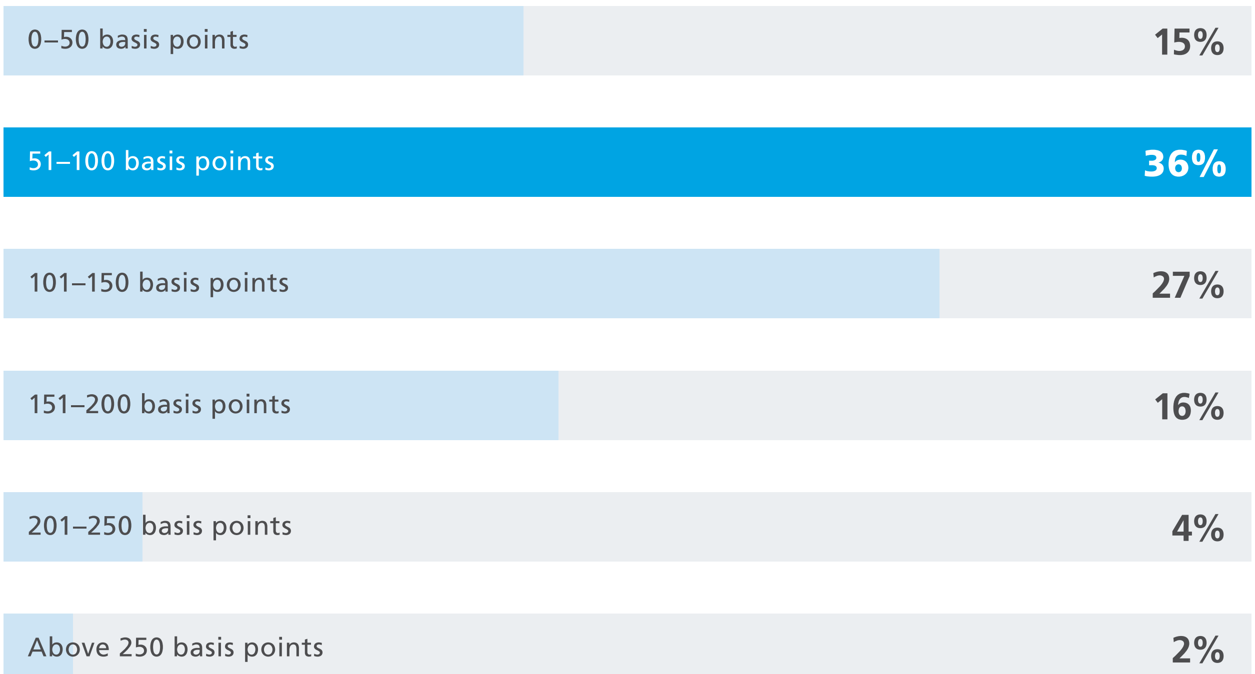
2%

Dovish: No rate increase



Notably, **a third of respondents (37 percent)** expect three rate increases in 2018, up from 14% last year.

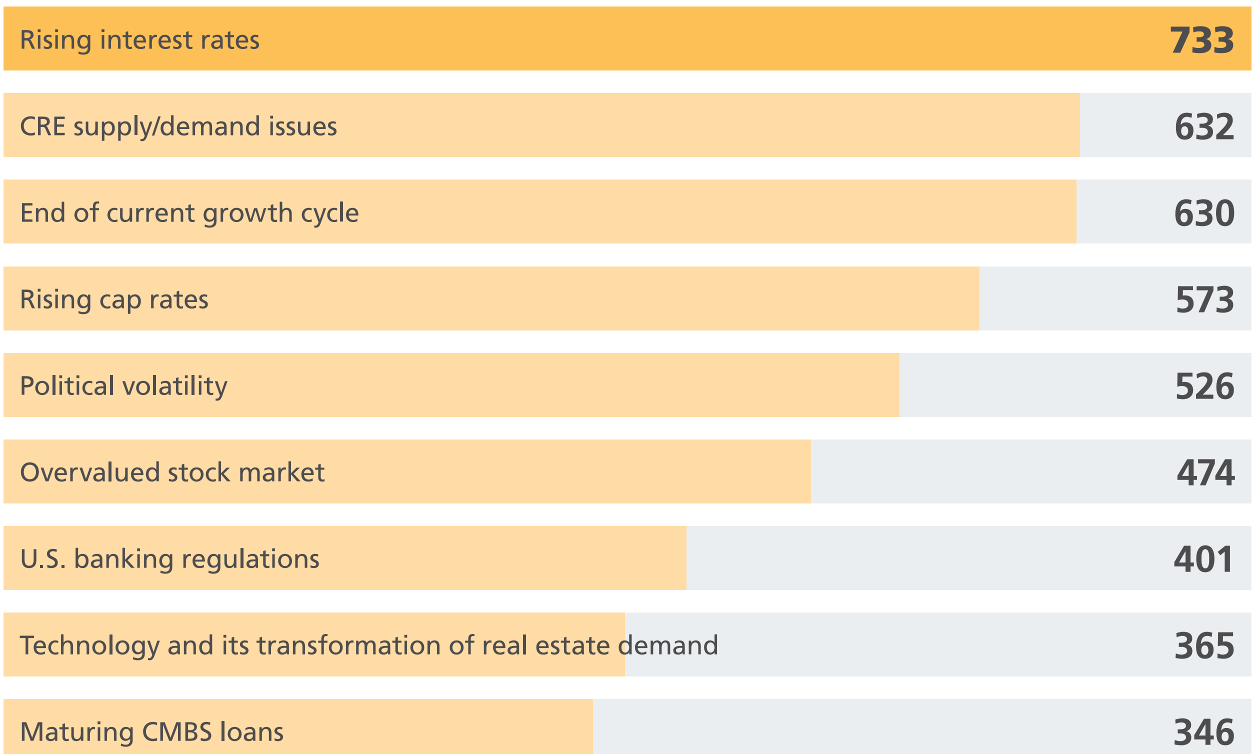
Q2: In 2018, how much of an increase in interest rates can the commercial real estate (CRE) industry absorb before there is a material adverse impact?



Consistent with the sentiment expressed for interest rate increases, most respondents (**36 percent**) believe the industry can only absorb 51-100 basis points.

27 percent believe the industry could safely manage an increase of 101-150 basis points.

Q3: Which of the following represent the greatest concerns for the CRE industry in 2018?



The three greatest concerns facing industry executives in 2018:

1. Rising interest rates (733)
2. CRE supply/demand issues (632)
3. End of current growth cycle (630)

The new concern added to this year's survey, end of the current growth cycle, replaced U.S. banking regulations (401) which fell to seventh below rising cap rates (573), political volatility (526), and overvalued stock market (474).

Maturing CMBS loans came in last (346) following technology and its transformation of real estate demand (365).

Q4: How long do you think the Tax Cuts and Jobs Act will extend the current positive industry cycle?

2018	2019	2020	2021	2021+	No Impact
10%	31%	27%	8%	9%	15%

In step with the expectation of multiple interest rate increases, most respondents (**58 percent**) believe that the Tax Cuts and Jobs Act will extend the positive industry cycle one to two years, while another 17 percent see these benefits extending beyond 2020.

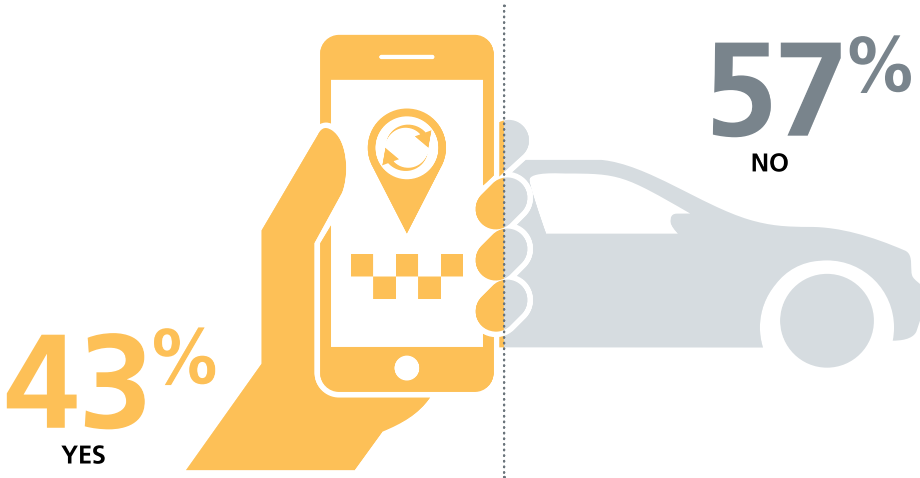
Q5: Which parts of the Tax Cuts and Jobs Act will have the most positive impact on the CRE industry?

Retention of Section 1031 like-kind exchanges for real property	451
Survival of carried interests	419
Reduction of corporate federal income tax rate	387
Immediate expensing of certain qualified depreciable personal property	373
Ability of real property businesses to elect out of new 30% limitation on business interest expense deduction	365
20% deduction for qualified business income of certain pass-through entities	356

The retention of Section 1031 like-kind exchanges for real property (451) and the survival of carried interests (419) will have the most positive impact on the CRE industry, according to respondents.

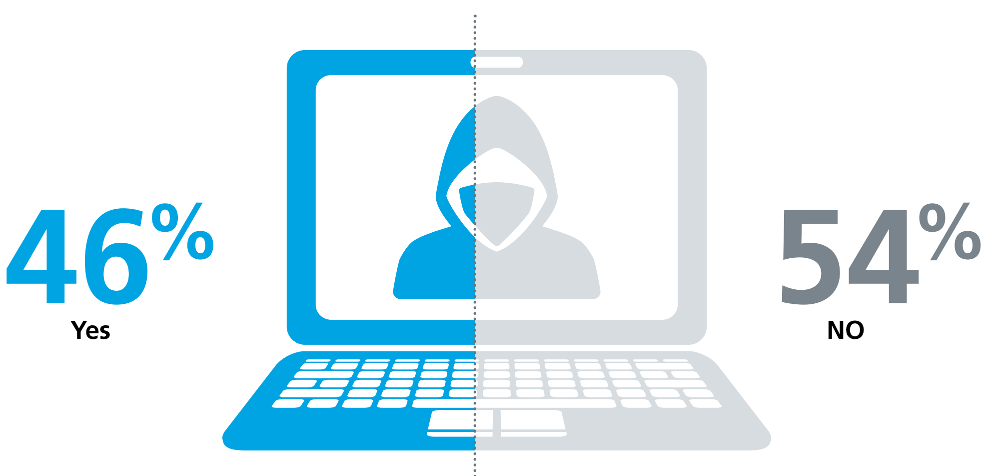
Reflecting the broad range of survey respondents and their hopeful attitude towards the legislation, all of the Tax Cut and Jobs Act provisions are viewed to have a positive impact for real estate.

Q6: Has the rise of ride-sharing services (Uber, Lyft, etc.) impacted your analysis and/or development of properties?



43 percent of respondents believe the rise of ride-sharing will impact their property analysis/development.

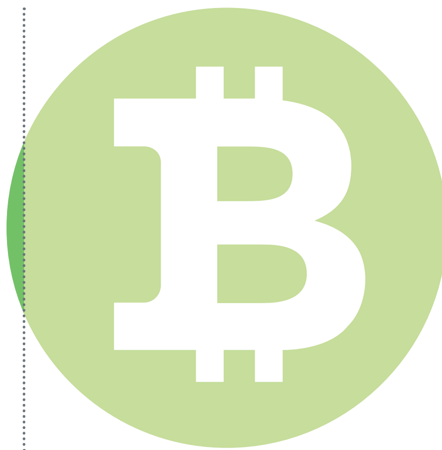
Q7: The CRE industry is a growing target for cyberattacks. Are you concerned about a cyberattack in CRE in 2018?



A significant number of survey respondents (**46 percent**) are concerned about a cyberattack in the next year.

Q8: With the market cap for cryptocurrencies approaching $1 trillion, do you plan to adopt bitcoin – or any other cryptocurrency – into your CRE transactions in 2018?

4% YES



96% NO

While the residential real estate industry has begun to dabble in bitcoin, the vast majority of respondents (**96 percent**) will not adopt cryptocurrency into their CRE transaction in 2018.

Q9: What is the greatest concern driving your decision not to use bitcoin/cryptocurrency?

Overall volatility	38%
Lack of understanding	25%
Lack of regulations	24%
Security concerns	13%

38 percent of respondents say their biggest concern is the new currency's overall volatility.

25 percent of respondents attribute their concerns to a lack of understanding. **24 percent** say the current lack of regulations gives them pause.

Q10: What will be your primary source of equity in 2018?

Private equity	30%
Institutional investors	29%
Individual investors	20%
We do not employ third party equity	16%
Foreign investors	4%
Other	2%

Virtually tied at the top, respondents indicate private equity (**30 percent**) and institutional investors (**29 percent**) as their primary sources of equity.

20 percent report individual investors will be their primary source of equity.

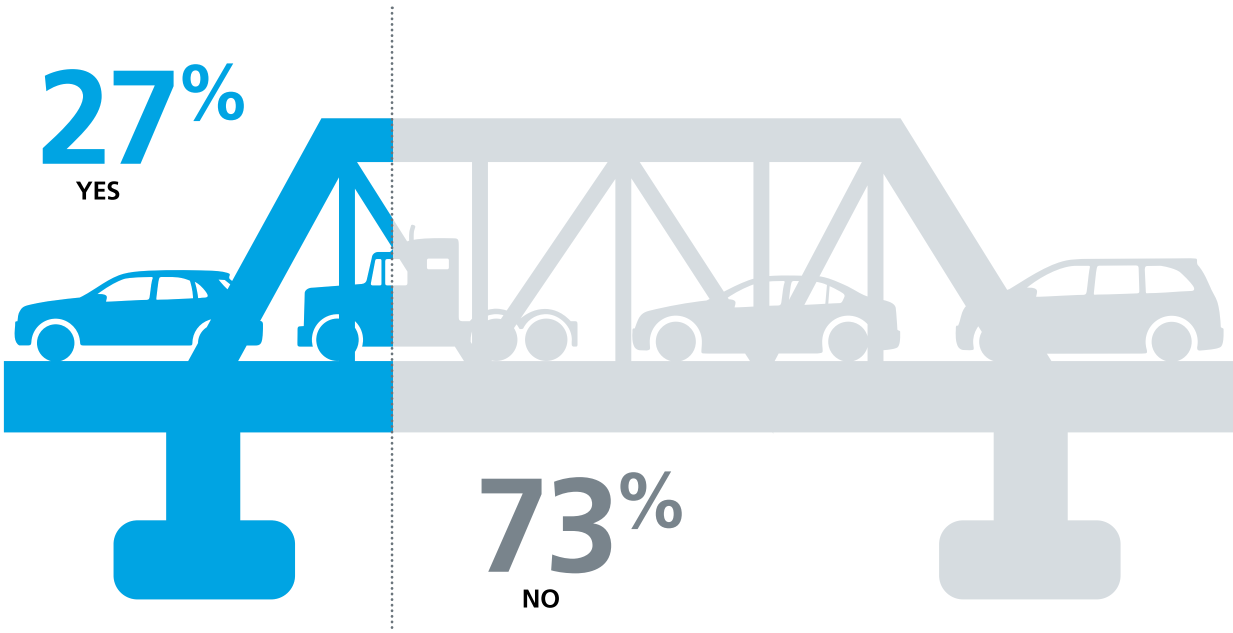
Q11: With the "wall of maturities" having peaked, what do you see as the most significant impediment to a substantial increase in the origination of CMBS loans in 2018?

Loss of market share by CMBS originators/competition by active lenders	34%
Investor demand	31%
Reaction to a weakening of loan safeguards (e.g., caps on non-recourse carve-out liability, interest only structures, etc.)	15%
Risk retention	14%
Volker Rule still being in effect	6%

Given the difficulty in dealing with CMBS and the presence of other originators, **34 percent** of respondents say the loss of market share by CMBS originators/competition by active lenders is the most significant impediment.

Respondents next list investor demand (**31 percent**) as a substantial impediment to a measurable increase in the origination of CMBS loans in 2018.

Q12: If infrastructure investment remains a priority for the Trump administration in 2018, will infrastructure be a part of your investment strategy?



With the understanding that infrastructure investment primarily impacts public private partnership (P3) projects, most survey respondents (**73 percent**) report that infrastructure will not be a part of their investment strategy in 2018.

Methodology

In January 2018, Seyfarth Shaw surveyed real estate executives via email to gauge their top concerns for the coming year, which included owners, developers, investors, asset managers, brokers, lenders and consultants. 157 respondents took the survey.

- Question No. 3 used an inverse weighted ranking system to score each response. For example in No. 3, 1 = 9 points, 2 = 8 points, 3 = 7 points, 4 = 6 points, 5 = 5 points, 6 = 4 points, 7 = 3 points, 8 = 2 points, 9 = 1 point.
- Question No. 5 used an inverse weighted ranking system to score each response. For example in No. 5, 1 = 6 points, 2 = 5 points, 3 = 4 points, 4 = 3 points, 5 = 2 point, 6 = 1 point.
- Question No. 9 was only made available to those who answered "No" to Question No. 8.
- Due to rounding, percentages used may exceed 100.

About Seyfarth's Real Estate Department

Seyfarth's Real Estate department is distinguished by its size, geographic footprint, and commitment to cutting-edge management techniques. As one of the largest real estate practices in the United States, Seyfarth's Real Estate team of more than 130 attorneys successfully helped clients close more than $30 billion in transactions in 2017. Independent organizations such as *Chambers USA*, *U.S. News & World Report*, and *The Legal 500* have recognized Seyfarth's market leading position in real estate law and clients praise us for being "extremely responsive, very reliable and exceedingly knowledgeable."

About Seyfarth Shaw

Seyfarth Shaw has more than 800 attorneys in 15 offices providing a broad range of legal services in the areas of labor and employment, employee benefits, litigation, corporate and real estate. Seyfarth's clients include over 300 of the Fortune 500 companies and reflect virtually every industry and segment of the economy. A recognized leader in delivering value and innovation for legal services, Seyfarth has earned numerous accolades from a variety of highly respected industry associations, consulting firms and media.