SEYFARTH SHAW

2019 | Real Estate Market Sentiment Survey

Executive Summary

As the country prepares to endure more political and financial volatility, commercial real estate executives cite rising interest rates and the end of the current growth cycle as their lead concerns for the industry this year, according to Seyfarth Shaw's 4th annual *Real Estate Market Sentiment Survey*. This focus on real estate fundamentals is best understood in the context of legislative gridlock and serious business threats, on the one hand, and new investment opportunities in opportunity zones, the cannabis business, and coworking spaces, on the other.

From a divided congress to cannabis investment to new coworking spaces, Seyfarth Shaw's 2019 Survey examines the industry's current market sentiment:

Fed Chief Takes Charge: To little surprise, given Fed Chairman Jerome Powell's announcement to raise interest rates in December 2018, only 6 percent of respondents surveyed in January 2019 expect three rate increases in 2019, down from 37 percent last year. President Trump's public distaste for interest rate hikes may also play a part in respondents' sentiment. However, as in every previous year of the survey, respondents are tremendously hawkish—as 91 percent expect at least one increase this year.

Cannabis Caution: The great majority of respondents (85 percent) do not plan on investing in the cannabis industry in 2019. Of substantial legal concern to companies pondering investment, marijuana is still considered a Schedule I drug by the Federal Government. With a patchwork of existing state cannabis laws and no legislative movement federally, banks continue to place limits on credit, thus complicating investment opportunities.

Coworking Confusion: 70 percent of commercial real estate executives report no increased investment in coworking spaces in 2019, notwithstanding the explosive growth of this product over the last few years. This survey response raises more questions than answers about the future of coworking: Is the industry facing a saturated market or are most businesses already in the coworking game?

Cyberattack Awareness: Concern for cyberattacks grew by over 20 percent in the last year. As news outlets continue to publish stories about large cyberattacks on notable brand companies, the real estate industry has taken notice of its vulnerability.

House Divided: The political landscape dramatically changed as of 2019, and President Trump faces a new power dynamic in Washington for the remainder of his first term. However, this shift doesn't seem to bother half the industry who report it will have no impact on the market. Only 37 percent believe the blue wave in the House will have a negative impact. In 2017, over two-thirds of respondents believed that the Trump Administration would have a positive impact on the market and one-third named Donald Trump the best presidential candidate for the industry in the firm's inaugural survey back in 2016.

End in Sight: Survey respondents are clearly indicating the industry's general sentiment that all good things must come to an end. The end of the current growth cycle, a new concern for a potential recession, and a continued fear of rising interest rates round out the top three concerns of 2019. The commercial real estate industry appears insusceptible to the turbulent political and financial news of the day as political risk, increased investigations and possible impeachment, and stock market volatility finish near the bottom of this year's list of concerns.

Tax Opportunities: Nearly one-third of survey respondents (32 percent) indicate that they will be taking advantage of the federal opportunity zone program as either an investor or sponsor in 2019. Of that group, almost one-third of real estate executives (32 percent) are investing in opportunity zones as a new source of investment capital, while another 25 percent plan to utilize the program as a way to defer current taxable gains.

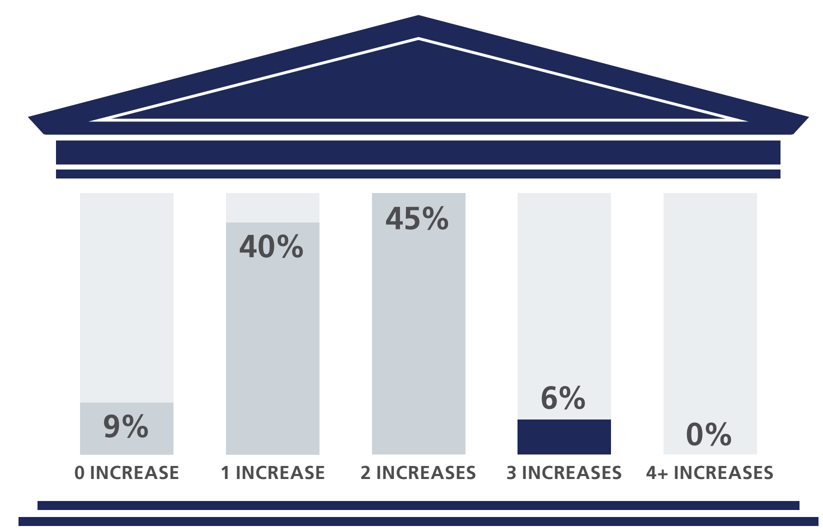
Q1: How many interest rate increases do you expect from the Federal Reserve in 2019?

Hawkish: At least one rate increase

Demonstrating solid confidence, **91 percent** of respondents believe the Federal Reserve will raise interest rates at least once in 2019.

9%

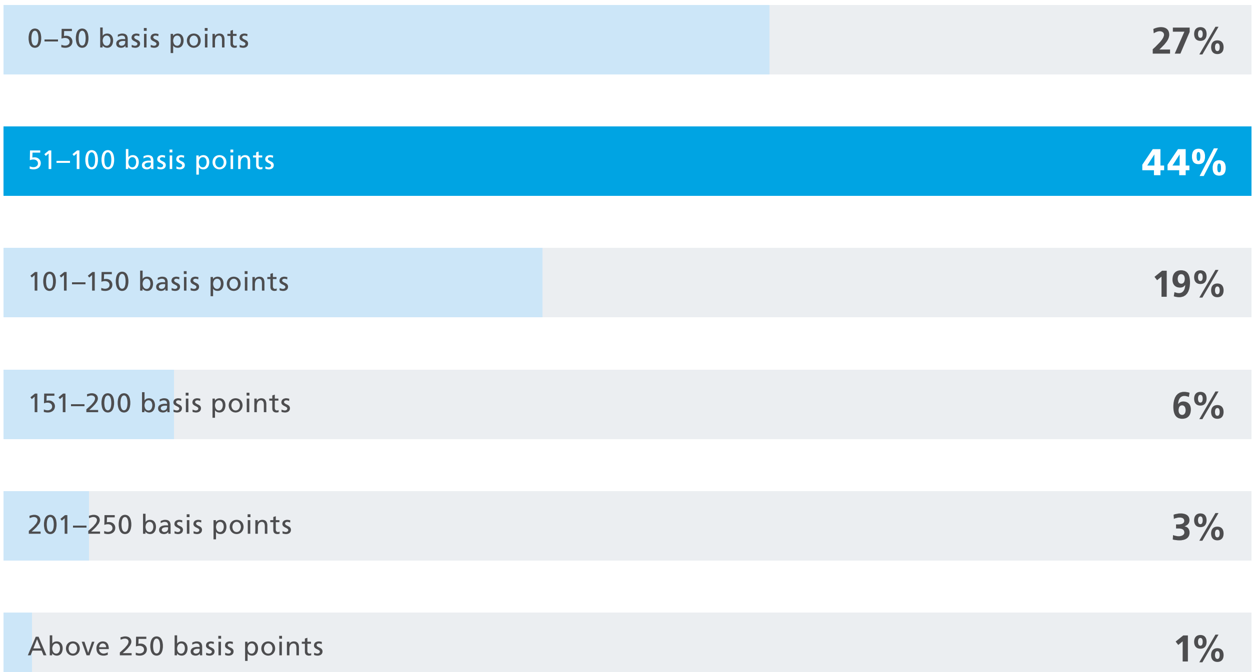
Dovish: No rate increase



Only 6 percent of respondents expect three rate increases, down significantly from 37 percent last year.

Please note that Fed Chairman Jerome Powell announced an interest rate hike in December 2018, shortly before the survey was conducted in January 2019.

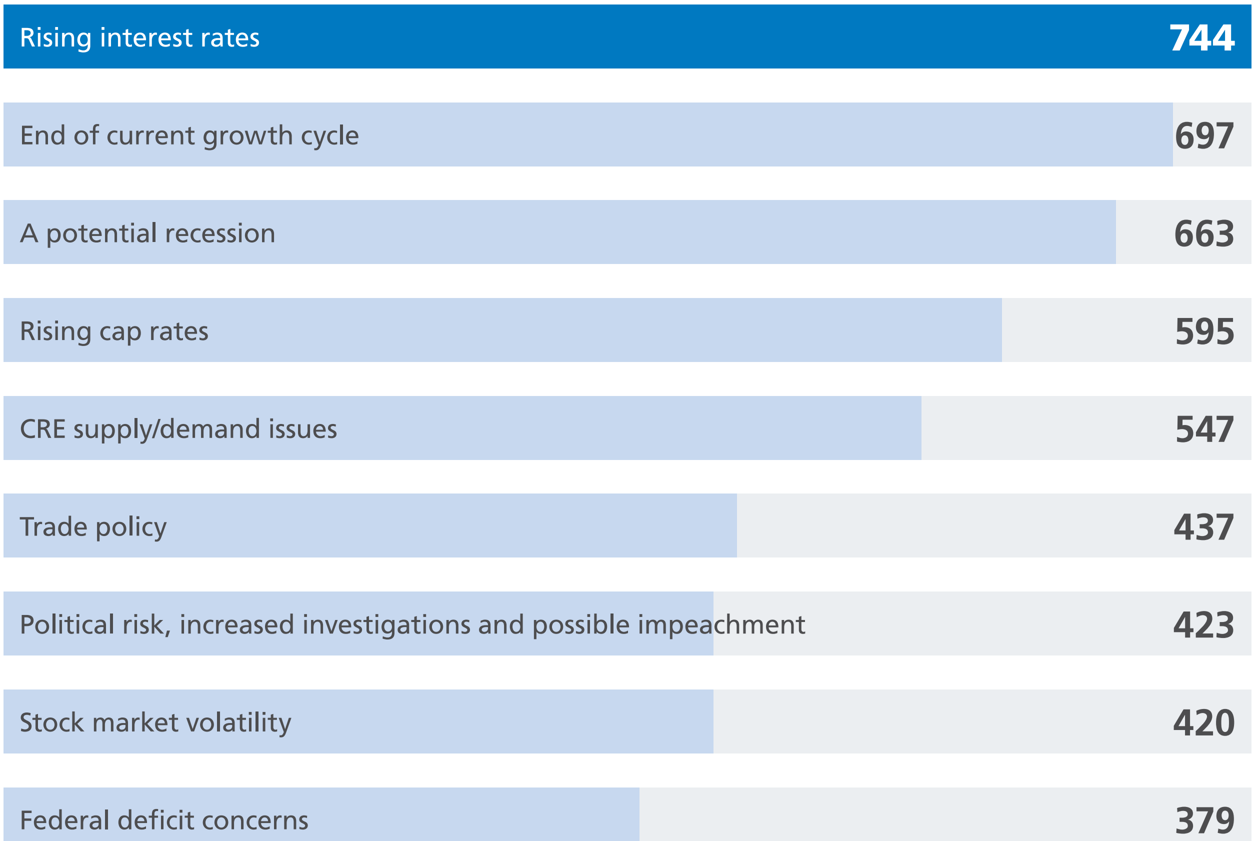
Q2: In 2019, how much of an increase in interest rates can the commercial real estate (CRE) industry absorb before there is a material adverse impact?



Nearly half of respondents (**44 percent**) believe the industry can only absorb 51-100 basis points.

27 percent believe the industry can safely manage an increase of 0-50 basis points, compared to **19 percent** who think the industry can absorb 101-150 basis points.

Q3: Which of the following represent the greatest concerns for the CRE industry in 2019?

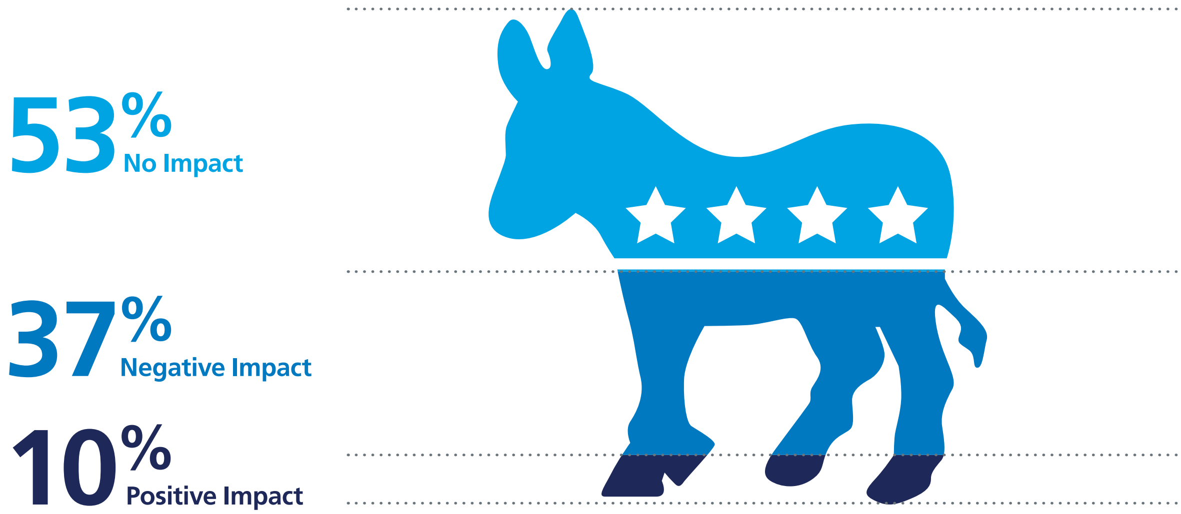


The three greatest concerns facing industry executives in 2019:

1. Rising interest rates (744)
2. End of current growth cycle (697)
3. A potential recession (663)

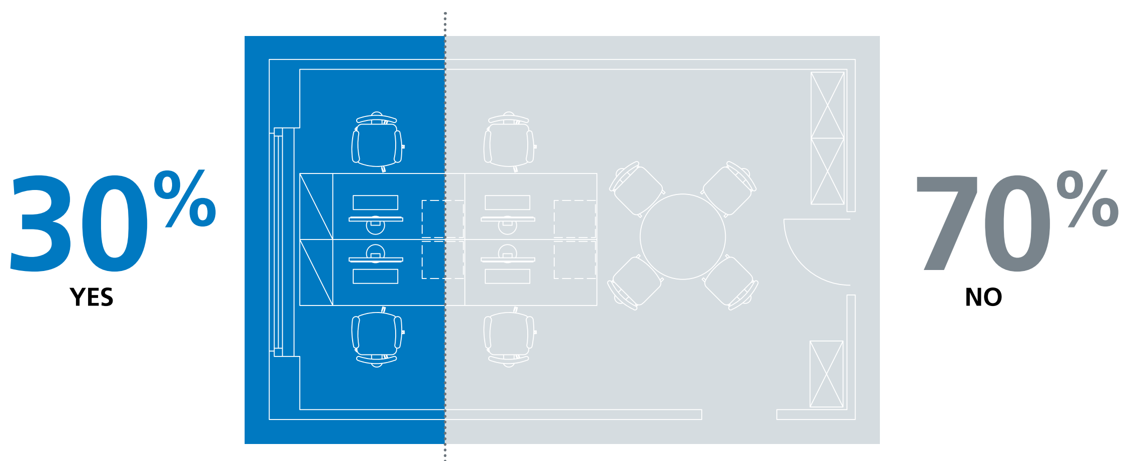
Survey respondents are signaling a slowdown in the market with their top three reported fears. CRE supply/demand issues (547) fell out of the top three this year to fifth, trailing rising cap rates (595).

Q4: What impact do you think Democratic control of the House of Representatives will have on CRE in 2019?



Respondents indicate business as usual this year as more than half (**53 percent**) believe new Democratic control of the House of Representatives will have no impact on the CRE industry.

Q5: With the emergence and success of coworking spaces, do you anticipate allocating an increased amount of dollars towards the lending/development/investment in this space in 2019?



Despite the growing trend of coworking spaces in the market, **70 percent** of survey respondents do not anticipate allocating increased dollars towards this space in 2019.

Q6: Which of the following federal programs will you utilize in 2019?

None	23%
Like Kind Exchange (1031)	19%
Opportunity Zone Investor	17%
Opportunity Zone Sponsor	15%
Historic Tax Credits	10%
New Markets Tax Credits	7%
Low Income Housing Tax Credits	4%
EB-5	3%
Other federal programs	3%

Not surprisingly, nearly one-third of respondents (**32 percent**) indicate they will utilize the benefits of opportunity zone structures—a tax benefit for a tax-driven industry.

Like Kind Exchange (1031) continues to be a popular program among commercial real estate executives. **19 percent** of respondents anticipate utilizing the tried and true program.

23 percent of survey respondents do not plan on taking advantage of any federal benefits in the coming year.

Q7: If you plan to participate in an Opportunity Zone structure, whether as a sponsor or investor, what is the primary reason for such investment?

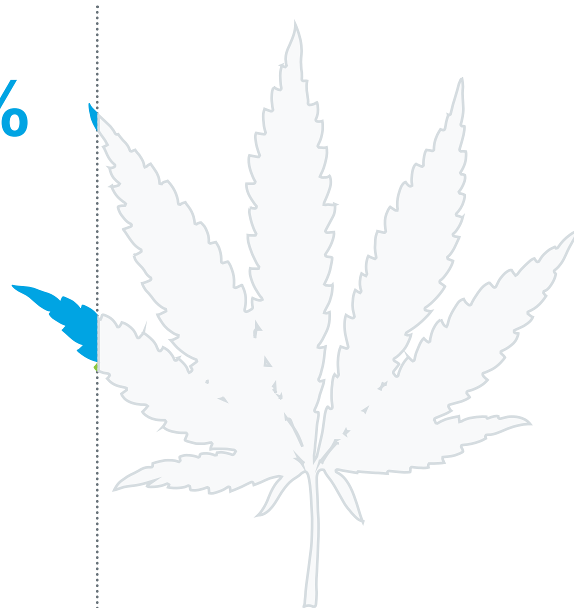
Capturing a new source of investment capital	32%
Deferring current taxable gains	25%
Reducing taxable gains from the investment	17%
Eliminating taxable gains in 10 years	15%
Impact investing	11%

32 percent of those taking advantage of the program are investing in opportunity zones as a new source of investment capital.

Showing high hopes for the new program, **25 percent** of commercial real estate executives will utilize opportunity zones as a way to defer current taxable gains.

Q8: With the cannabis industry expected to reach roughly $47 billion by 2027 in North America, have you or do you plan on engaging in any CRE transaction or investment in the cannabis industry?

15% YES



85% NO

With overwhelming assurance, **85 percent** of survey respondents are pumping the brakes when it comes to embarking in the cannabis industry.

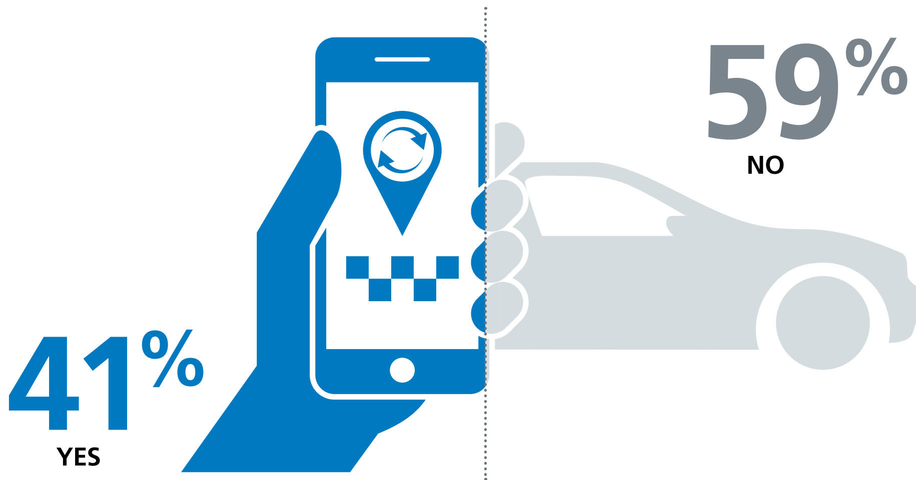
Despite a growing trend of state legalization, the lack of both federal legislation and credit availability from financial institutions has adversely impacted investing from the commercial real estate space.

Q9: What is your time horizon for a CRE transaction in the cannabis industry?

2-5 years	70%
Our business is already in the cannabis industry	20%
Within the next year	10%

Of the 15 percent of respondents who plan to engage in the cannabis industry, most (**70 percent**) do not plan to invest anytime soon, indicating an investment horizon of at least 2-5 years. Notably, however, **20 percent** of those respondents planning to participate in the industry already have their hands in the pot business.

Q10: Has the rise of ride-sharing services impacted your analysis and/or development of properties?

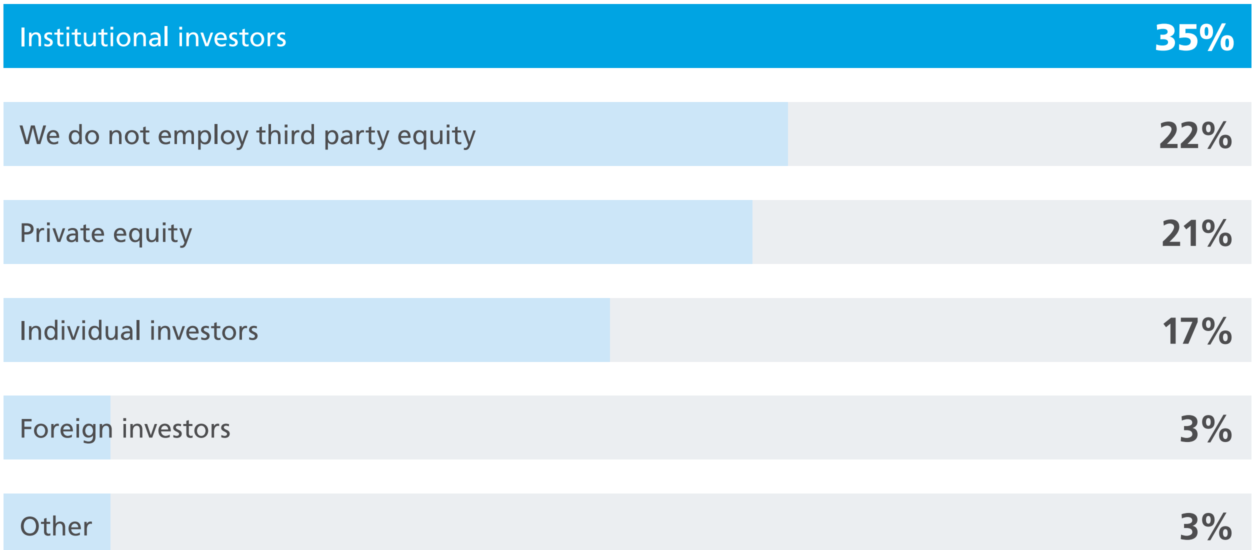


Consistent with last year's sentiment (43 percent), **41 percent** of respondents this year believe the rise of ride-sharing will impact their property analysis/development. This trend is poised to continue and evolve over the next decade.

Q11: The commercial real estate industry is a growing target for cyberattacks. Are you concerned about a cyberattack in CRE in 2019?

69 percent of respondents are concerned about a cyberattack hitting their business in 2019, a significant increase compared to last year (46 percent).

Q12: What will be your primary source of equity in 2019?



Compared to last year (16 percent), more respondents (**22 percent**) do not plan to employ third party equity. If they do, most (**35 percent**) are looking to institutional investors.

Outside of the major U.S. markets, there appears to be no appetite for substantial foreign investment. Only **3 percent** of executives chose that option.

21 percent report private equity will be their primary source of equity, the second most popular source.

Methodology

In January 2019, 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. 140 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. 9 was only made available to those who answered "Yes" to Question No. 8.
- Due to rounding, percentages used may exceed 100.

About Seyfarth Shaw

Seyfarth Shaw has more than 850 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.

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 120 attorneys successfully helped clients close more than $50 billion in transactions since 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."

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