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2014 FORECAST

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The future for real estate is bright

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As we enter 2014, it is important to take stock of the market and to properly plan for the year ahead. The first quarter, in particular, often serves as a bellwether for the health of the overall lending market and is key to getting great loan pricing. Lenders are eager to hit their budget goals early and thus pricing (loan spreads) typically are tight in the first quarter of the year. Add in the CREF-Mortgage Bankers convention in the first week of February and spreads further compress. The convention is usually where the tenor and mood of the upcoming year's market can be gauged.

There remain a number of unknowns that should play out in the first quarter, which will impact the lending environment. Namely the fate of the Federal Open Market Committee's (FOMC) monthly $85 billion economic stimulus in the form of Treasury notes more commonly known as Quantitative Easing 3 or QE3, which has led to suppressed interest rate levels for the past year. The Fed recently announced that it will reduce bond purchases by $10 billion per month effective immediately, but the future remains unclear – will they continue tightening or ease off the brake? Owners should look forward, evaluate prepay premiums and recast debt now, locking in these historically low rates before they are gone.

"With real estate fundamentals improving following a tumultuous fall over the past several years and interest rates forecast to rise, now is the time to invest and lock in low rates."

This sentiment is supported by the findings of the Emerging Trends in Real Estate® 2014 report released by PwC US and the Urban Land Institute (ULI), which notes that interest rates will rise in 2014. Interview subjects and survey respondents agree that interest rates are going to rise just moderately this year. The potential for rising rates leaves a lingering shred of uncertainty and discomfort over higher interest rates, which will muddle the exit strategy for investors if cap rates rise. "The question on everybody's mind is how long interest rates are going to stay low. What happens when, five years from now, rates are up?," noted a real estate service provider in the report.

In addition, there are still questions regarding the economy's overall health. While 2013 saw steady improvement in unemployment, both at the national and state level, it certainly has not been due to any sort of fiscal responsibility on the part of Congress or President Barack Obama. And with debt projected to be up a whopping 238% from below $7 trillion to over $22 trillion by the end of the President's second term in 2017, there is a very real sense of fear that rates will skyrocket and ratings agency downgrades will take hold, especially with confusion about Obamacare further clouding employers hiring practices.

Despite economic uncertainty, the real estate recovery will gain momentum in 2014, according to the Emerging Trends in Real Estate® 2014 report. This should be good news to an industry that has experienced a recovery of fundamentals that has been much slower than it is used to after a recession. Economic and demographic changes will drive demands for real estate that are familiar and some that will require the industry to adapt, according to the report. Equity and debt capital will continue to be attracted to the asset class, and the deployment of this capital will include more investment strategies that will involve a wider set of markets and property types.

In particular, moderate- and high-income apartment development prospects, as well as moderate-income investment prospects, remain among the strongest of all sectors rated for 2014 by the Emerging Trends survey respondents. Millennials (or 'gen Yers'), who show a preference for living in a walkable, urban area, regardless of the size of the city where they live, will continue as a strong source of demand. They are less likely to buy their own homes, according to America in 2013: A ULI Survey of Views on Housing, Transportation, and Community. Drawing from a statistically representative sample, the study indicates that 54% of gen Yers rented their primary residence in 2013, compared with 32% of all adults in the United States. Of those gen Yers who are very likely to move within five years, 69% expect to rent, compared with 25% of all adults. Meanwhile, baby boomers are also selling their homes to rent apartments within walking distance of downtown areas or moving into centers for active seniors.

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