FEATURED ARTICLE

IS THE BULL MARKET NEARING AN END?

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For over a half decade we've been in an up-cycle, and commercial real estate professionals are starting to wonder how much momentum is left before the inevitable happens and the market begins heading south; or to put a little more colorfully, is the bull market headed for the abattoir?

> **"INDUSTRIAL MARKETS CONTINUE TO LOOK SO GOOD, TALK OF THE BULL MARKET GOING TO PASTURE IS ALMOST NON-EXISTENT."**

If markets were interference free, they generally would run about seven to 10 years before turning, but government oversight and financial engineering has both extended cycles and crashed the economy. After a severe recession in the mid-2000s (felt most strongly in the commercial and residential real estate industries) there has been a long, sloping recovery. While it's hard to read the tea leaves, it appears that parts of the commercial real estate market might have peaked.

"This up-cycle began in 2011 and so here we are seven years into a cycle that usually runs 10 years from peak to peak," observes Jim Anthony, SIOR, CEO of Colliers International in the Raleigh-Durham office. "There are signs that the market is finally moderating, including a halt to cap rate compression and even some moderate cap rate rising."

For the local view, *SIOR Report* checked in with commercial real estate professionals in cities in the Southeast, Midwest, and Southwest, and for a national perspective, Colliers International supplied some data points.

For our most recent data, as of the first quarter, Colliers reports office market fundamentals are at the strongest point in the cycle with peak occupancy and record rents, yet it also stated the market is cooling: occupancy is static, rental improvements are moderating, while investor strategies shift to suburban and secondary markets for higher yields.

Meanwhile, industrial markets continue to look so good, talk of the bull market going to pasture is almost non-existent. The U.S. industrial market held strong in the first quarter of the year, reports Colliers. Overall net absorption helped drop the vacancy rate to an all-time low, while demand kept new development solid and pushed asking rental rates to an all-time high.

For those on the transaction side of the business, Colliers was positively buoyant: nearly $14 billion in industrial assets changed hands in the first quarter of 2017, 3 percent higher than first quarter last year.

So let's take a look at what all that means in a few local markets: two areas of the country red hot for growth, North Carolina and Arizona; and one with slower economic expansion, the Midwest.

Except for Florida, no other eastern state has experienced as much expansion as North Carolina. For folks in the commercial real estate business, tar-heel interest usually just meant Charlotte, but that has changed over the past decade with Raleigh getting a lot of new attention.

"Raleigh has gotten much buzz about being a burgeoning tech market and a destination for millennials," says Anthony. "We have biotech and entrepreneurial software companies popping up. Job growth has been extremely positive and that has led to population growth."

Just how buzzworthy is Raleigh?

"From 2014 through 2016, there were dramatic increases in the volume of investment sales in all property types," says Anthony. "Apartments have traded hands furiously, industrial has been bid up to the highest levels in our market in terms of price per square foot and lowest cap rates, and Class A industrial buildings have seen sales at $80 a square foot. The best properties with the highest clear heights and best quality buildings haven't sold for under $60 a square foot."

Anthony adds, a few office transactions have achieved record prices and $330 a square foot has been recorded three times in our market. A mixed-use property Anthony's company sold called Pavilion East at Lakeview went for $335 a square foot.

While that all sounds great, Anthony cautions Raleigh has seen the peak in pricing for this cycle and the velocity of investment sales have begun to slow. Sellers trying for record prices have

been disappointed, which Anthony says, "tells you investors are not comfortable pushing the market up anymore. They are now anticipating moderating prices."

In Raleigh-Durham, multifamily cap rates are still in the 4 to 5.5 percent range depending on class and location. There were some sub-4 percent sales back in 2015, but those are no longer happening, says Anthony. Office market sales are usually 6.5 to 8 percent cap rate, while industrial cap rates range from 6.5 percent for long-term good credit leases, up to 8 percent for lower class older properties.

I've been through a number of cycles," says Anthony. "I don't see any imminent reasons why there would be a crash, but we are definitely going to see moderation in pricing."

Just a two and a half hour drive to the southwest sits North Carolina's biggest city, Charlotte, which, unlike Raleigh, expects good times in commercial real estate to continue.

"The bull market is not nearing an end," says John Culbertson, SIOR, CRE, CCIM, the managing partner for Cardinal Partners in Charlotte. "Everyone is looking at multifamily where there are signs of slowing, but indications suggest not enough housing and a lot of smart developers are continuing to look for new apartment sites."

Charlotte dominates Mecklenberg County, which for the past 10 years, has been one of the fastest growing metro areas in the country. Home to Bank of America and other large banks, Charlotte was resilient during the downturn. The big surprise is that Charlotte is also the entry point for the burgeoning automotive industry in nearby South Carolina.

"The industrial sector is hot," says Culbertson. "Rents continue to rise and there is a lot of development that is in the pipeline. I anticipate continued growth in the industrial sector here because we are an economy driven by the momentum of our own growth, which continues to have long-term growth projections for distribution. E-commerce is also expanding, accounting for 9 percent of total industrial absorption right now."

Charlotte is a more regional e-commerce industrial market for companies trying to get same-day or next-day delivery. As a result it gets few 1 million-square-foot facilities; most distribution buildings are in the 250,000 to 500,000-square-foot range.

"Occupancy rates have been at record levels (93.1 percent occupancy for Class A space) and absorption is the highest since 2005," says Culbertson. "Rents are up 15 percent over the past three years. Market rents for Class A is $4.65 a square foot. Over the next six months, vacancies will increase as new products are being brought on the market. Rental rates should remain steady."

Culbertson concludes, "The easy money for investors has been made, but there is still money to make."

The fastest growing county in the country is not in North Carolina, but in Arizona. Maricopa County, home to the sprawling Phoenix metro, takes the title, and as can be expected the commercial real estate market has been good. Peter Batschelet, principal and industrial specialist with Lee & Associates in Phoenix, doesn't expect that to change any time soon, especially in regard to industrial.

"If the country continues at a 1.5 percent or 1.9 percent GDP growth that's good, we'll have another 18 to 24 months without a hiccup – provided all the external factors remain stable," says Batschelet.

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