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# Integra Realty Resources Commercial Real Estate Experts

IRR provides world-class, comprehensive commercial real estate market research, valuation, and advisory services. Every IRR office is led by a MAI-designated Senior Managing Director, averaging over 25 years of commercial real estate experience in their local markets.

Locate an IRR Expert



# PRESENTATION OVERVIEW



- Macro Economic Conditions
  - Lender Survey
- Local Property Sector Performance
  - Cap Rate Overview

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# PART ONE

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**Macro Economic View**

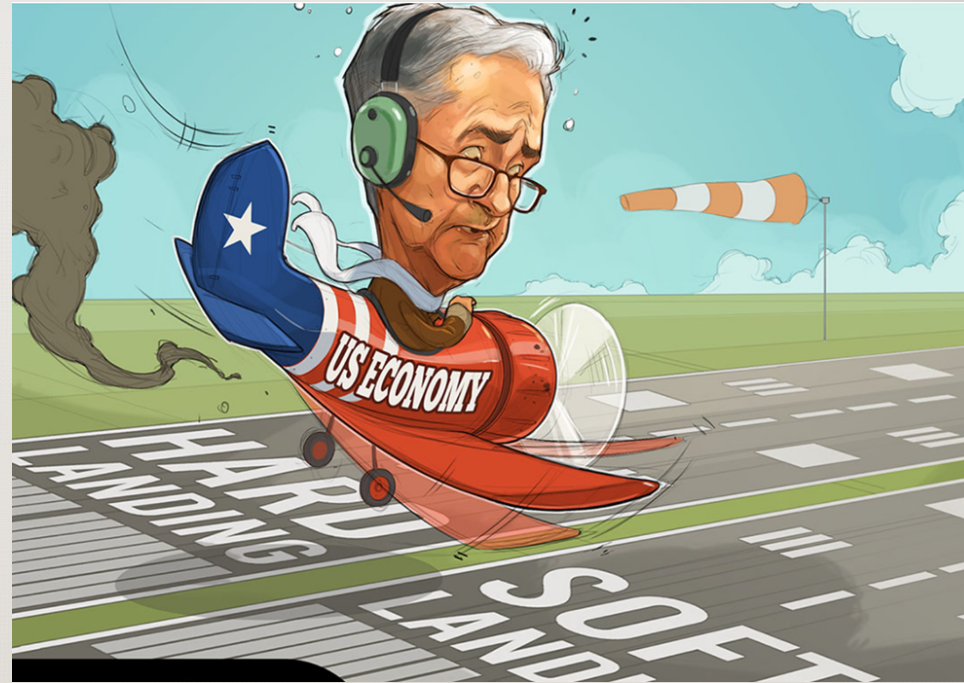
## ECONOMIC CONDITIONS – MACRO VIEW

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- Understanding the current and potential economic conditions is necessary to fully appreciate how commercial real estate may be impacted.
- Canary in the coal mine



# ECONOMIC CONDITIONS LOTS OF HEAD WINDS FUNDAMENTAL IMPACT ON REAL ESTATE



# CURRENT STATE OF AFFAIRS EVENTS

War in Middle  
East

High Interest  
Rates

Consumer  
Credit Cards  
Maxed Out

Unemployment  
increasing

Sticky Inflation

U of M  
Consumer  
Sentiment Low

## Mixed Bag of Opinions

# RECESSION WARNING

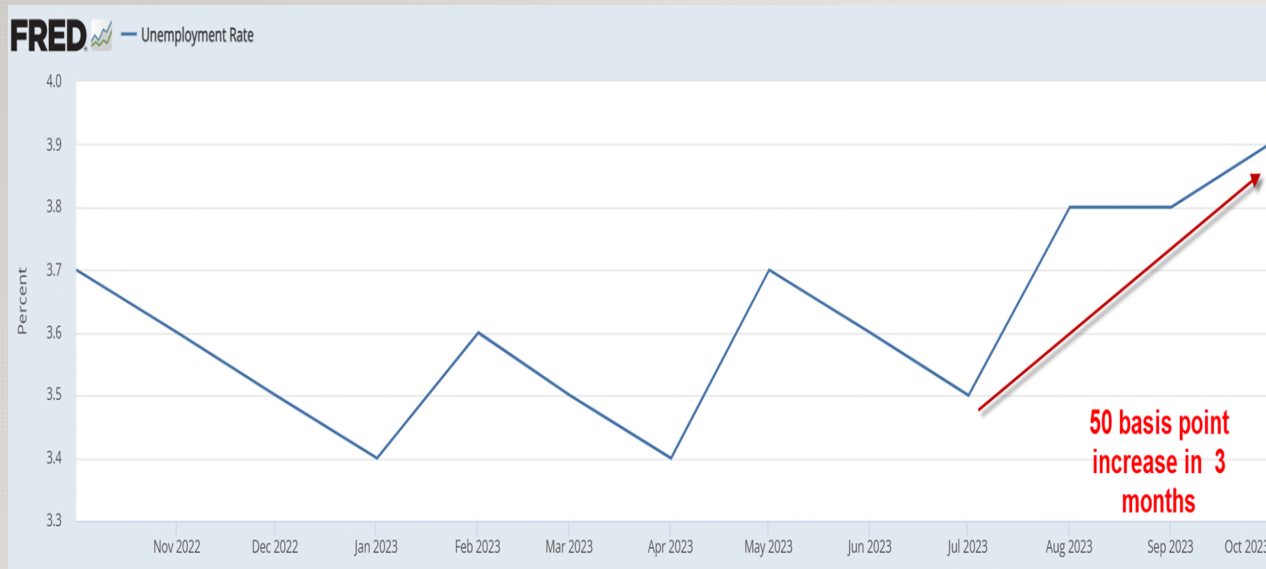
- Reuters revises outlook to no recession
- Morgan Stanley mild recession late 2024
- Kiplinger delays recession forecast to mid 2024
- Goldman – changes out look to very mild recession

FINANCE · AMERICAN ECONOMY

**Recession is likely in 2024 because companies face a 'huge shock' of having to refinance debt at higher interest rates, top strategist warns**

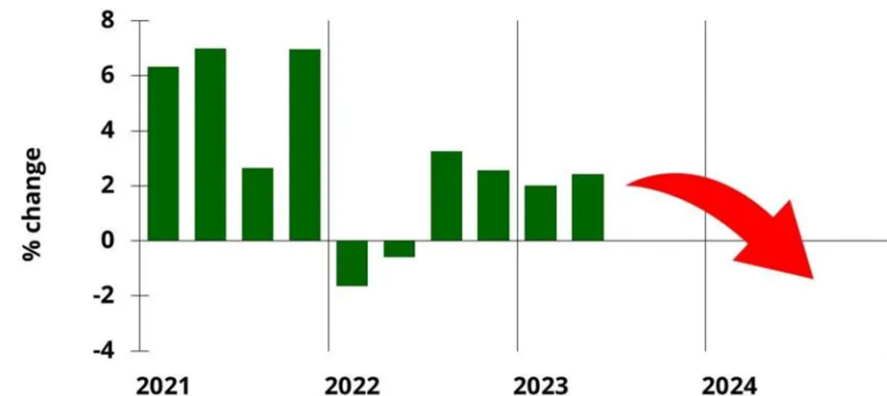
BY EMILY GRAFFEO, ANYA ANDRIANOVA AND BLOOMBERG

September 1, 2023 at 1:22 PM EDT



**Forbes**

### Economic Forecast



Recession likely in 2024. DR. BILL CONERLY. HISTORICAL DATA FROM U.S. BUREAU OF ECONOMIC ANALYSIS

# INFLATION PROVES STICKY

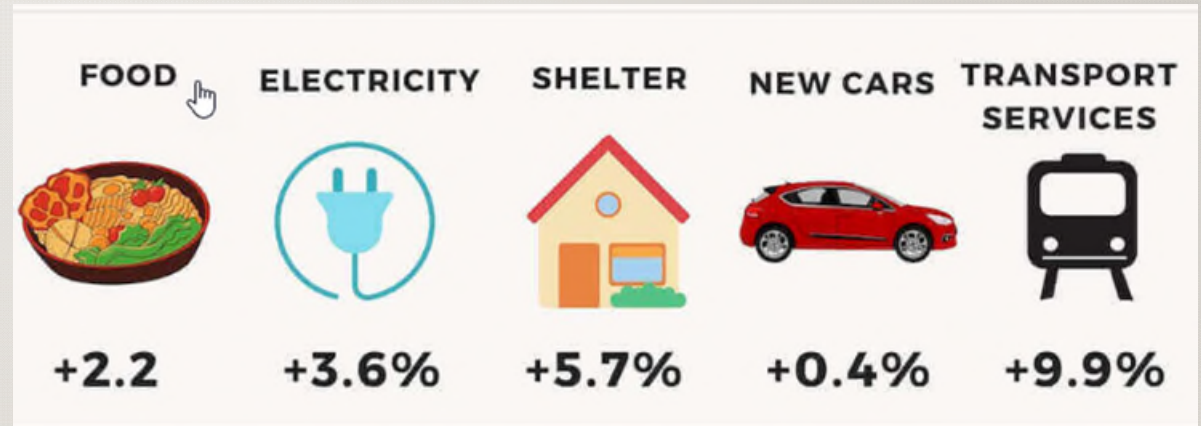
- Inflation continues into fall months 2024
- Starting to normalize and approach target levels

Energy  
Costs

Food  
Costs

Shelter  
Costs

Necessities





# HOUSING MARKET – MIXED OUTLOOK

**Low inventory continues to boost new residential construction**

**Mortgage Applications in the U.S. Hit a 28-Year Low**

📅 September 7, 2023 [Finance, US News](#)



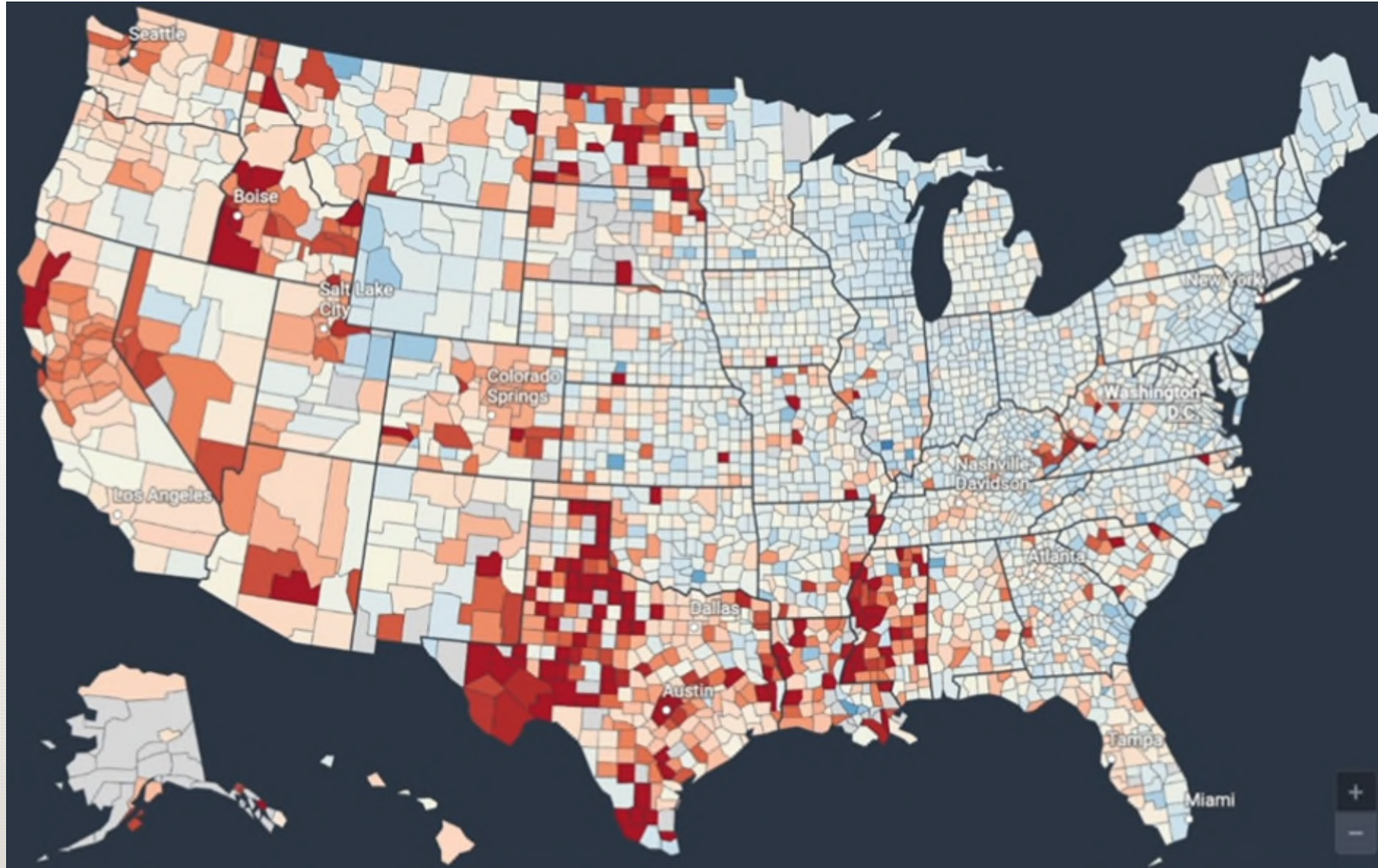
High mortgage rates – 7.15%

60% have mortgage under 4%

Low inventory

Michigan market performing well

# HALF THE COUNTRY IN HOUSING CORRECTION





The Real Estate Market  
FLIPPED | Open Door, Zillow...



Housing Crash Begins! We  
Just Witnessed Something...



ZILLOW: Cancelled Contracts  
SKYROCKET

**Redfin predicts sharpest turn in housing market since 2008 crash**  
After two years of record high sales, data shows the housing market is starting to cool down



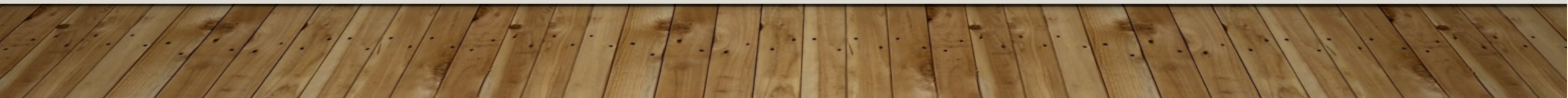
re: WARNING: These are the Top 10 Cities  
Where 2022 Housing Crash...Won't...



The Housing Crash is Happening RIGHT  
NOW! (PROOF)



HOUSING CRASH ABOUT TO



## HOUSE PRICE DECLINE BUT MOST MARKETS ARE STABLE

- Supply is still limited
- Owner's marooned in existing homes
- Longer days on the market
- More price drops
- Sales below list price in many markets
- Mortgage Applications lowest in 30 yrs
- National Market is slumping
- Local Detroit Market is stable

## Where Home Sellers Are Cutting Prices

	State	Percentage of Listings With Price Reductions
1.	Arizona	40.4%
2.	Nevada	36.8%
3.	Utah	32.3%
4.	Colorado	29.2%
5.	Idaho	37.2%
6.	Washington	25.3%
7.	California	23.4%
8.	Texas	25.3%
9.	Georgia	21.7%
10.	South Carolina	21.7%



Source: Realtor.com

realtor.com

## Mortgage application volumes plunge

The surge in interest rates has driven mortgage application volumes to the lowest since 1995, suggesting the housing market may remain under pressure for some time to come.



Note: Gray bands are recessions

Source: Mortgage Bankers Association

# AND THE GOOD NEWS?



STOCK MARKET  
PERFORMING WELL



RETURNS OF 5% IN  
LOW-RISK  
INSTRUMENTS



TSA/TRAVELER NUMBER  
UP

- Consumer consumption remains healthy
- Election Year Stability?

# ECONOMIC CONDITIONS – TAKEAWAYS

- Economy is changing – signs of slowing
- Fed Reserve - Aggressive interest rate policy continues
- Housing market correction taking place already in some States
- Inflation may have peaked but may be stubborn and persistent
- Recessionary warning/probability
- Interest Rate are worrisome (higher for longer?)
- Unemployment ticking up
- Bright spots in the economy despite bad news

# PART TWO

Commercial Lending Environment

The Wall Street Journal news department was not involved in producing this sponsor content.

ECONOMY | ECONOMIC OUTLOOK | REAL ESTATE

## Commercial Real Estate 2024: Adapting to New Realities

The coming year is expected to be pivotal for real estate firms, testing their ability to recover and thrive as they continue to confront multiple challenges and shifting expectations

Share | Resize

Listen (30 min)

SEARCH DELOITTE



A new survey report reveals concerns about the state of the economy, sentiments that will likely continue to be a primary factor in global real estate leaders' decision-making through 2024 and beyond.

### WHAT'S TRENDING

1. Audit Committees: So Much More Than Financial Statement Oversight
2. The Dirt on Legal Data—and How to Clean It
3. First Bias Audit Law Starts to Set Stage for Trustworthy AI
4. The World Needs Carbon Markets. Here's How to Make Them Work Better.
5. At Mayo Clinic,

# CRE LENDING ENVIRONMENT

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J.P.Morgan



## What Did I Ask

- Describe the current lending environment from your standpoint
- Expectations for 2024
- Deposit exodus and impact on lending
- Regulatory changes
- Banking layoffs
- Increased reserve requirements or loan loss provisions
- Current mortgage rates
- Distressed assets/Work out
- Refinance risk/issues
- Macro economic outlook

# Big Picture Takeaway – Common Themes



Interest Rate Trend is problematic



Loan Default Trend is happening



Loan renewals are challenging

- Lots of dynamic change occurring over just the last 45 days (since Labor Day)
- Comments were almost universal in these three key areas

# FED PIVOT – THAT HAS NOT YET HAPPENED

- Last 12 months there has been an expectation of Fed lowering rates
- Six rates cuts, down to 3 rate cuts down to no rate cuts?
- We are in a higher interest rate environment for a while
- Market is resigned to current rate environment



# Lenders need to be profitable

Spreads are now 250 to 300 basis points

Because of perceived market risk, most are closer to 300 bp over index.

Stricter underwriting requirements

Reduced LTV – 60% many cases

Credit quality borrowers with liquidity

Borrowers are not excited about these stricter loan terms

Examples of Current Rate Environment

SOFRA Rate: 5.40%

300 bp spread over

Effective mortgage rate 8.4%

Ten Year Rate: 4.9%

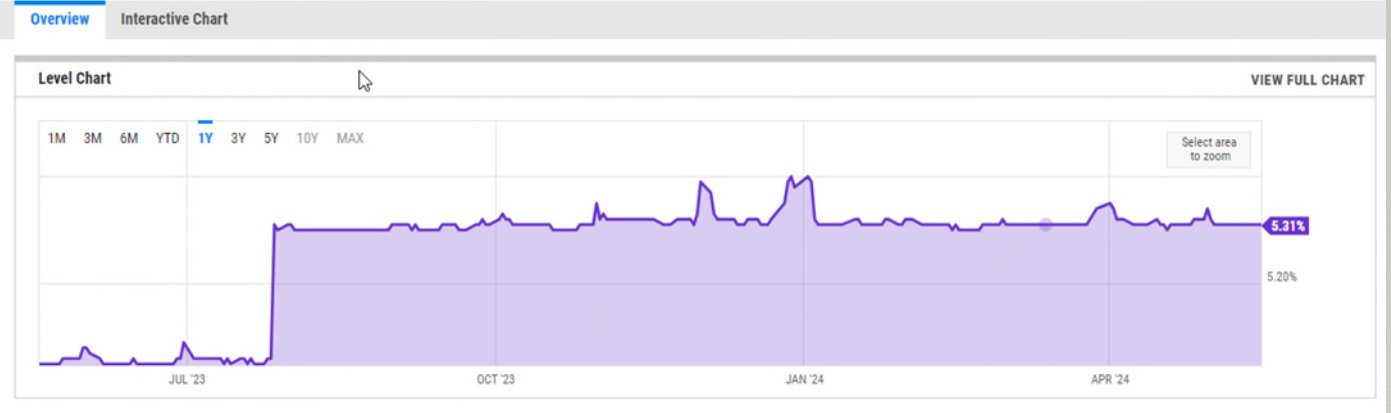
Many banks 250 spread over

Effective mortgage 7.5%

Rate Indexes:  
Almost every lender thinks the current rate environment is approaching peak but that we will remain at this level for a while

### Secured Overnight Financing Rate (1:SOFR)

5.31% for May 16 2024



### U.S. 10 Year Treasury Note

ADD TO WATCHLIST

4.426%

0.00

Last Updated: May 17, 2024 5:03 p.m. EDT

PREVIOUS CLOSE

4.426%

4.426

DAY RANGE

4.426

3.554

52 WEEK RANGE

5.022



## Cash in Refinance

Many deals rolling over are problematic

Even if nothing has changed with the real estate; same tenants, similar NOI, etc.

Going from 4% to 8% creates DCR issues and other covenant issues

Right sizing (reducing) the loan amount is primary objective for the lender



## Expectations for Deal flow for Qtr4 and 2024

- Loan Originations will be similar or slower than what occurred in first 9 months of 2023
- Construction loans are challenging due to risk in cost/prices, interest rate environment and risk from floating to perm
- The new high in mortgage rates may stick around for a while, and harder to do deals in the 8% range





Loan Originations from  
Regional Banks will be slower  
than 2021-2023 era

Construction loans are  
challenging due to risk in  
cost/prices, interest rate  
environment and risk from  
floating to perm

The new high in mortgage rates  
may stick around for a while;  
harder to do deals in the 7.5%  
range

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## EXPECTATIONS FOR DEAL FLOW 2024

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# PART THREE

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Property Sector Performance

Apartment Sector



# APARTMENT SNAP-SHOT METRO DETROIT

1

Market Rent  
Average  
\$1,195 up  
since 2019

2

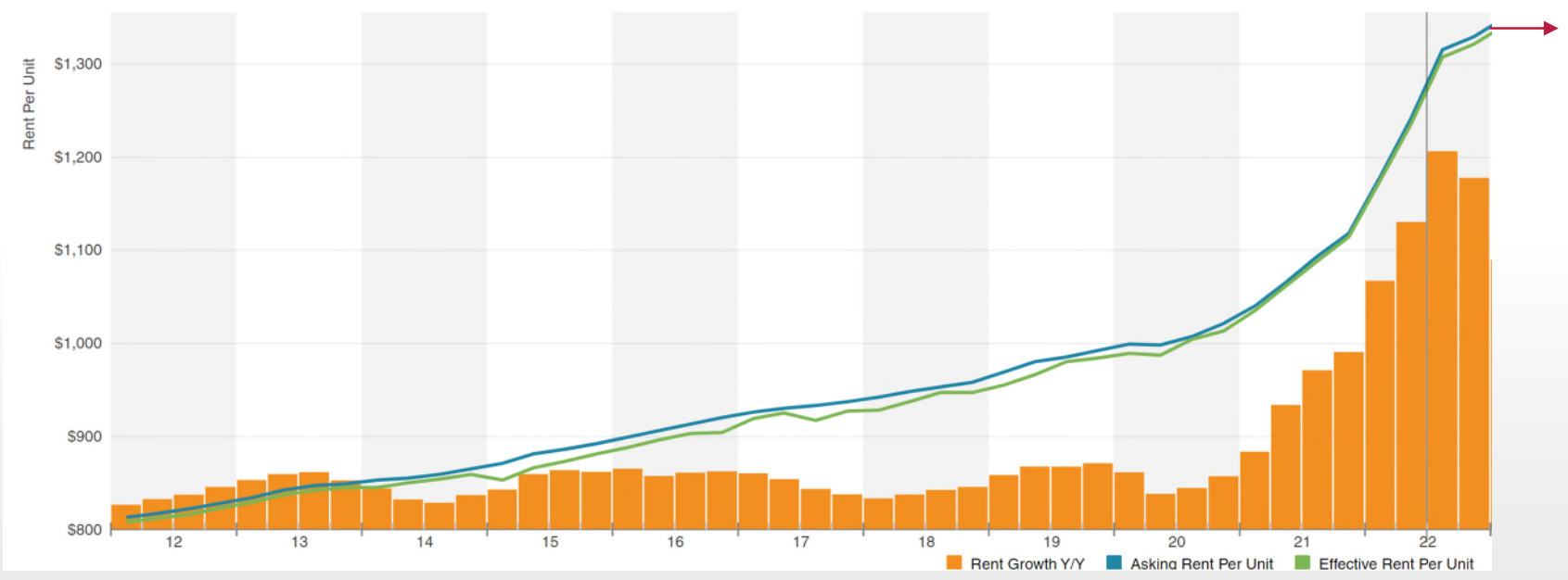
Market  
Vacancy  
average 6.8%  
stable

3

Market Sale  
Price/unit  
\$94,800 and  
decreasing

4

Market Cap  
Rate 6.75%  
has been  
increasing

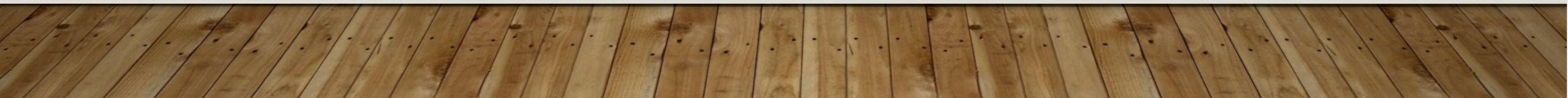


# APARTMENT SECTOR

CAP RATE	SALE PRICE/UNIT	AVERAGE SALE PRICE	SALES VOLUME	SALE VS ASKING PRICE	AVERAGE UNITS	MONTHS TO SALE
6.8%	\$124,683	\$17.2M	\$1.5B	-10.0%	121	4.8



CAP RATE	SALE PRICE/UNIT	AVERAGE SALE PRICE	SALES VOLUME	SALE VS ASKING PRICE	AVERAGE UNITS	MONTHS TO SALE
7.4%	\$115,839	\$9.4M	\$206M	-8.2%	60	9.5





Carnegie Park Apartments  
26601 W. Carnegie Park Dr.  
Southfield, MI 48034  
ID: 3038667

Multifamily  
Conventional,  
Garden/Low Rise  
176 Apt. Units  
Built in 1987  
9.95 Acres

Closed: 06-28-2023  
\$20,500,000  
**\$116,477 / Unit**  
5.70 OAR



Woodbridge Apartments  
3140 E. Paris Avenue  
Kentwood, MI 49512  
ID: 3033461

Multifamily  
Conventional,  
Garden/Low Rise  
168 Apt. Units  
Built in 1981  
14.70 Acres

Listing: 08-03-2023  
\$17,000,000  
**\$101,190 / Unit**  
7.60 OAR



Silver Lake Hills  
Apartments  
3200 Foley Glen Dr.  
Fenton, MI 48430  
ID: 3020300

Multifamily  
Conventional,  
Garden/Low Rise  
310 Apt. Units  
Built in 1999-2001 and  
2014  
33.00 Acres

Listing: 06-26-2023  
\$43,600,000  
**\$140,645 / Unit**  
5.75 OAR



Concorde Club Apartments  
7080 Niagara St.  
Romulus, MI 48174  
ID: 3011555

Multifamily  
Conventional,  
Garden/Low Rise  
160 Apt. Units  
Built in 1967  
8.81 Acres

In-Contract: 05-08-2023  
\$10,350,000  
**\$64,688 / Unit**  
6.80 OAR



Sherwood Heights  
8805 Kingswood St.  
Detroit, MI 48221  
ID: 2990706

Multifamily  
Conventional,  
Garden/Low Rise  
313 Apt. Units  
Built in 1954-1964  
16.77 Acres

Closed: 01-30-2023  
\$20,500,000  
**\$65,495 / Unit**  
6.71 OAR



# INDUSTRIAL SECTOR

---



# INDUSTRIAL SNAP-SHOT METRO DETROIT

1

Market Rent  
Average \$8.24/SF  
up from \$7.65/SF  
one year ago

2

Market Vacancy  
average 3.3% has  
trended  
downward

3

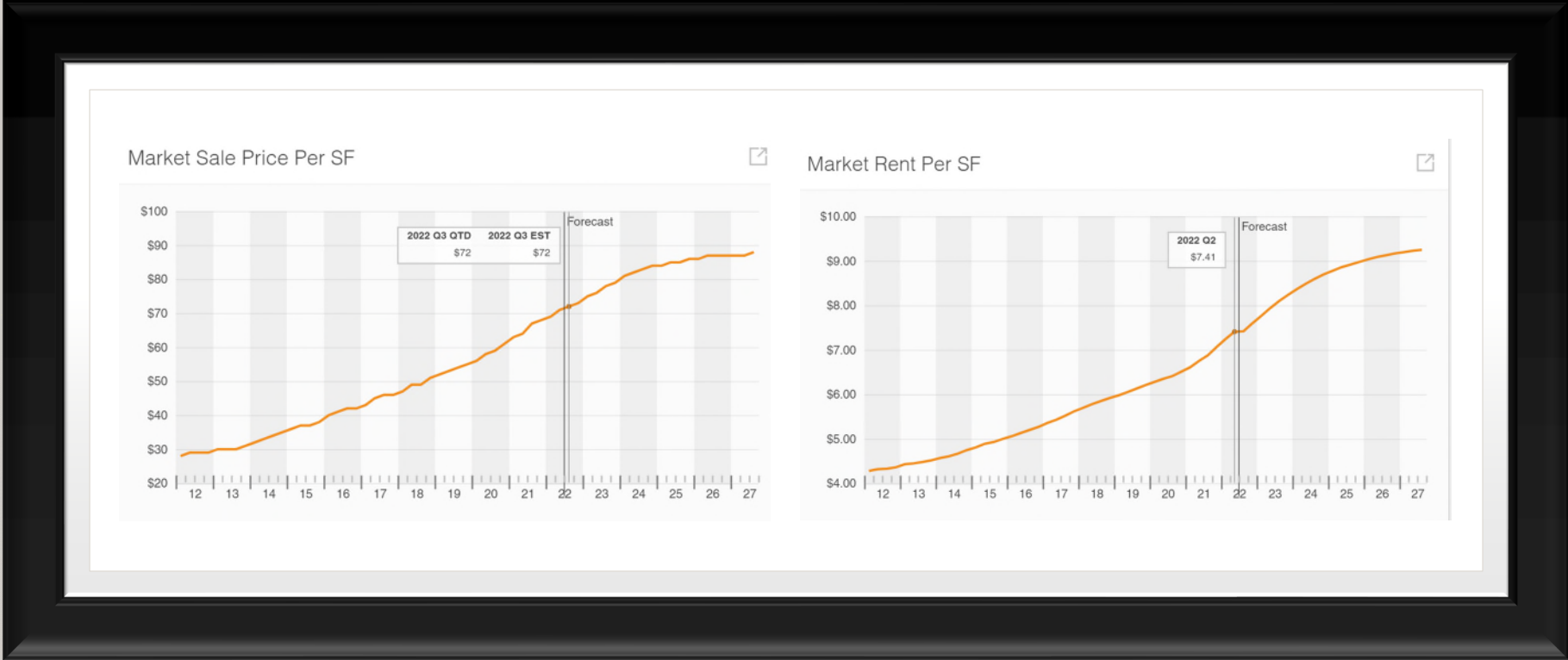
Market Sale  
Price/SF \$80/SF  
and increasing

4

Market Cap Rate  
8.0% has been  
stable

## Industrial Comparison

	<u>Fall 2020 Covid Period</u>	<u>Fall 2023</u>
Rent	\$7.25	\$8.14
Vacancy	5.00%	3.30%
Sale Price	63	72
Cap Rate	8.75%	7.80%



# INDUSTRIAL SECTOR (CONT.)

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### Vacancy Levels at all time lows:

- Washtenaw Co. 4.2%
- Macomb Co. 2.0%
- Oakland Co. 3.5%
- Wayne Co. 3.9%
- Detroit 6.3%

## SALE PRICE TRENDS





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Office Network

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## Material and Labor Cost Escalation Continues to Drive Increases in Construction Costs

July 06, 2022

*Trade contractors to be more selective about the projects they pursue.*

# INDUSTRIAL CHALLENGES

- Cost to construct is expensive
- Typically exceeding \$125/SF
- Value often falls short of cost to build unless strong leases in place
- A result of material and labor costs increasing faster than values

## Survey of Industrial Brokers:

Active leasing market

Active sale / leaseback market

Rental rates and sale prices have increased

Cap rates continue to be compressing but stabilizing

# Retail Sector



# RETAIL SNAP-SHOT METRO DETROIT

1

Market Rent  
Average  
\$22.13/SF up  
from \$20.70/SF  
one year ago

2

Market Vacancy  
average 5.2%  
stable

3

Market Sale  
Price/SF \$138/SF  
down from  
\$148/SF one year  
ago

4

Market Cap Rate  
7.4% has been  
increasing



## Retail Market mid 2021 to mid 2022

CAP RATE	SALE PRICE/SF	AVERAGE SALE PRICE	SALES VOLUME	SALE VS ASKING PRICE	AVERAGE SF	MONTHS TO SALE
7.2%	\$148	\$1.8M	\$698M	-6.2%	13K	12.9

## Retail Market Trailing 12 Months

CAP RATE	SALE PRICE/SF	AVERAGE SALE PRICE	SALES VOLUME	SALE VS ASKING PRICE	AVERAGE SF	MONTHS TO SALE
7.4%	\$138	\$1.1M	\$305M	-7.6%	9.4K	11.6

**Prcie Per Square Foot Declined 7%**

**Aggregate Saels Volume reduced in half**

# BRICKS AND MORTAR

---

- Contrary to popular belief, Bricks and Mortar is not dead
  - B & M stores grew faster than e-commerce for the first time ever in the past 12 months
  - Physical stores 18.5% vs e-commerce 14.2%
  - Historically, e-commerce has grown at roughly 13% annually except during 2020 Covid year where it grew 31%



Kilmar Plaza  
435 E. Big Beaver Rd.  
Troy, MI 48083  
ID: 3048215

Retail  
Shopping Center  
16,684 SF  
Built in 2012  
Parking Ratio: 2.46

Vinnie & June Brow and  
Grooming Bar  
1,534 SF  
3/1/2024; 60 mos.  
\$38.00/SF/Yr, Triple Net  
Esc.: Fixed Steps



Brookdale Shopping  
Center  
22171-22385 Pontiac Trail  
South Lyon, MI 48178  
ID: 2974974

Retail  
Shopping Center  
87,153 SF  
Built in 1981  
Parking Ratio: 6.88

Athletico PT  
2,500 SF  
2/9/2023; 60 mos.  
\$21.00/SF/Yr, Triple Net  
Esc.: 3%/Yr.  
TI/SF: \$12.80



Brookdale Shopping  
Center  
22171-22385 Pontiac Trail  
South Lyon, MI 48178  
ID: 2974971

Retail  
Shopping Center  
87,153 SF  
Built in 1981  
Parking Ratio: 6.88

Pilates  
1,600 SF  
5/1/2023; 60 mos.  
\$17.00/SF/Yr, Triple Net  
Esc.: \$0.50/SF/Yr



Shopping Center  
30478 Milford Rd.  
New Hudson, MI 48165  
ID: 2974959

Retail  
Shopping Center  
36,408 SF  
Built in 2003  
Parking Ratio: 2.99

Confidential  
1,333 SF  
3/10/2023; 60 mos.  
\$25.00/SF/Yr, Triple Net  
Esc.: Fixed Percentage



Chelsea Courtyard  
Shopping Center  
1145 S. Main St.  
Chelsea, MI 48118  
ID: 2923415

Retail  
Shopping Center,  
Strip/  
Convenience Center  
31,537 SF  
Built in 2004

Henry Ford Medical Center  
2,400 SF  
8/31/2022; 72 mos.  
\$22.00/SF/Yr, Gross  
Esc.: \$0.50/SF/Yr.

OFFICE SECTOR



# OFFICE SNAP-SHOT METRO DETROIT

1

Market Rent  
Average  
\$20.75/SF stable  
since 2019

2

Market Vacancy  
average 26%  
increased since  
2019 at 14%

3

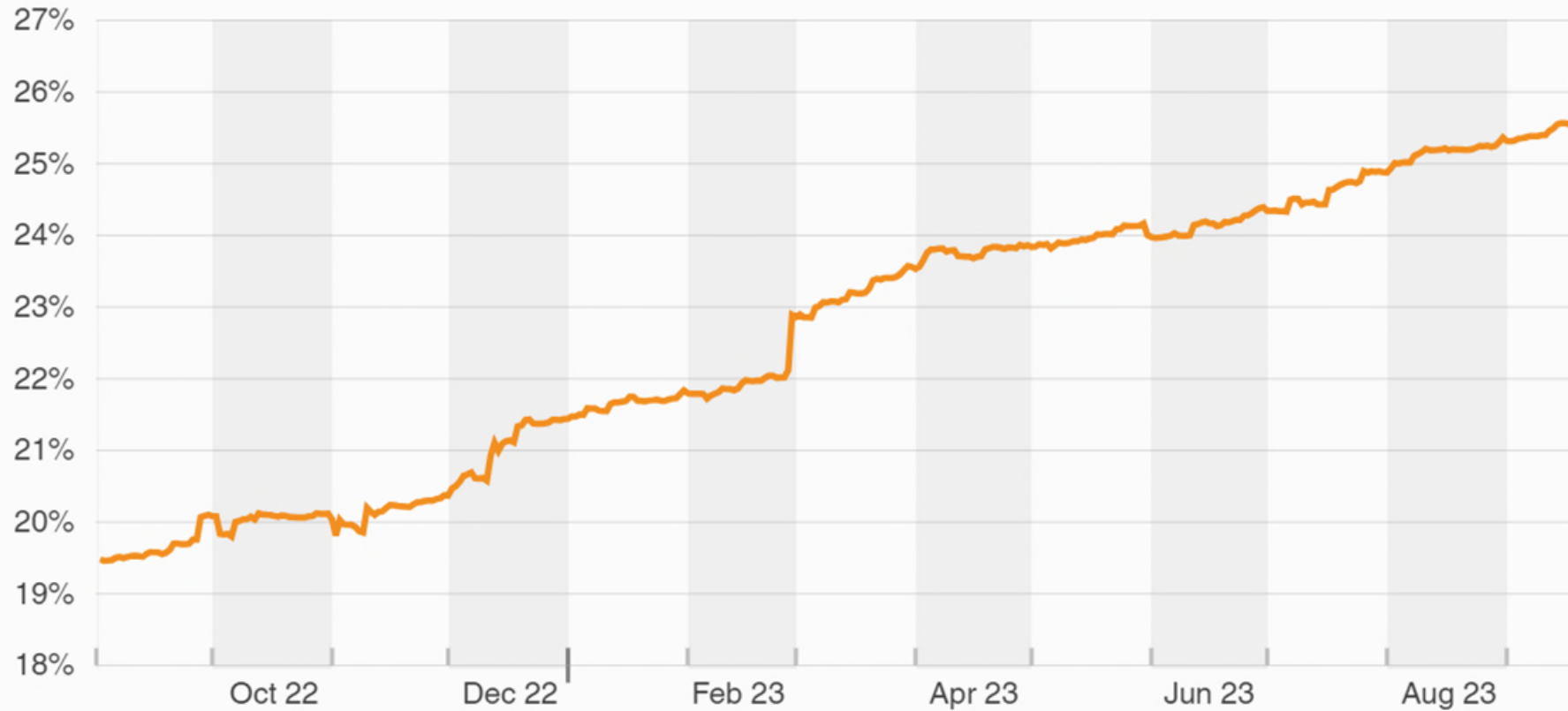
Market Sale  
Price/SF \$107/SF  
decreasing -7%  
Y-over-Y

4

Market Cap  
Rate 9.2%  
increasing over  
prior periods

# VACANCY TREND INCREASING REMOTE WORK STILL IMPACTING

Daily Vacancy Rate

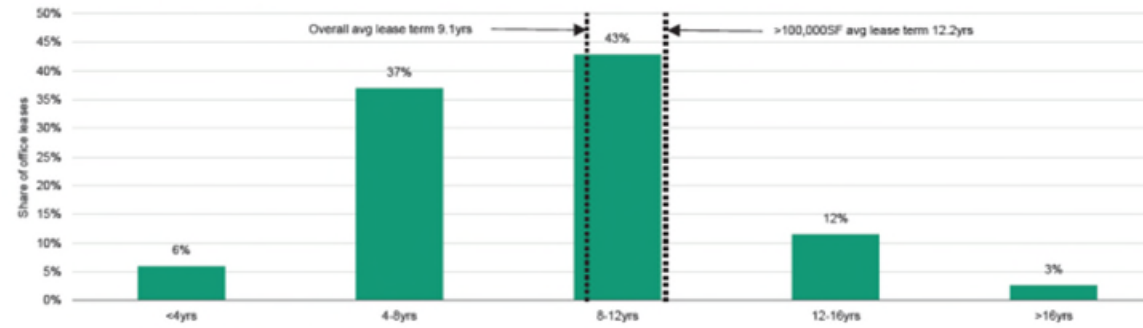


# YEAR OVER YEAR COMPARISON

- Time Period: 2021 – 2022
  - Avg Office Selling Price: \$121/SF
  - Number of Transactions: 574
  - Sales Volume: \$948M
- Time Period: Trailing 12 Months
  - Avg Office Selling Price: \$107/SF
  - Number of Transactions: 401
  - Sales Volume: \$497M

# The Evolution of Office Will Take Time

The majority of office lease terms are greater than eight years  
Distribution lease terms for US offices of 10,000 SF or more



Sources: Moody's Investor Service, Moody's Analytics, Compstak



# LEASE SPACE GIVE BACK AT RENEWAL

Trends showing 20% to 30% reduction in lease space upon renewal

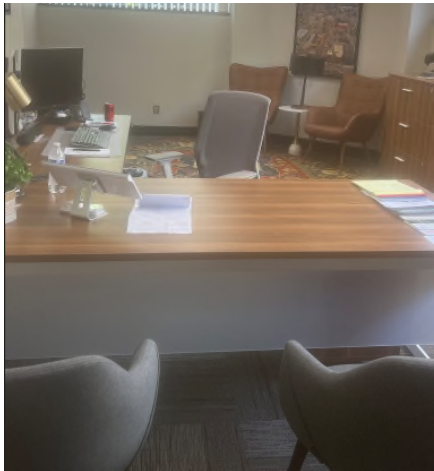
Some tenants expanding to provide more space per employee but rare

Some tenants consolidating space into a single location (Comerica and Huntington Bank examples).

**Food, concerts and more: Can they help lure workers back into offices?**



## The Integra Example





# OFFICE TAKEAWAYS

- Macro concerns – WFH impacting lease renewals
- May take years to play out as leases are long term
- Supply could flood the market
- Micro level – Metro Detroit office market is stable
- Lots of transactions
- Prices have declined slightly

# BEST PERFORMING ASSETS CLASS

- Medical property
- Distribution and warehousing
- Dollar Stores
- Self-storage
- Class A Apartments
- Lower Tier Restaurants
- Grocery
- Health Care
- Big Box – Target, Walmart, Costco, etc.

# CONCLUSION

**Macro Economics:** suggest dark clouds and high-pressure brewing

**Micro Economics:** hard data at the local level suggest commercial real estate market is performing reasonably well, or stable in most case

**How will the second half of 2024 shape up:**

??????

# CAP RATES

Why such a mystery?



# DEFINITION

It's a rate of return that an investment property generates....

Its based on its annual income relative to its value or purchase price

The cap rate is the standard used in investment real estate practice to understand pricing and gauge expectations of returns

The cap rate is also used compare real estate investments



# CAP RATE SHOULD REFLECT

- Risk of ownership
- Location
- Property type
- Overall Condition
- Cash flow sustainability
- Neighborhood 10 years from now
- Maintenance necessary during new ownership





$$\text{Value} = \frac{\text{Net Operating Income}}{\text{Cap Rate}}$$

**BASIC FORMULA**

# APPLYING THE FORMULA



We know the following:

- Leased for \$120,000 annually
- Landlord expenses are \$20,000
- Market Cap rates averaging 7%

• Net Income     \$100,000



• Cap Rate                     7%



• Value                     \$1,425,000

# APPLYING THE FORMULA



We know the following:

- Leased for \$120,000 annually
- Landlord expenses are \$20,000
- Just sold for \$1,425,000

• Net Income      \$100,000



• Sale Price            \$1,425,000



• Cap Rate                7%

# WHERE DO CAP RATES COME FROM

- Market Evidence

Capitalization Rate Comparables								
No.	Property Name	City	Year Built	Sale Date	Rentable Area	% Occup.	Price/SF	Cap Rate
1	Office Building	Saint Clair Shores	2000	12/9/2022	16,532	100%	\$154.25	8.99%
4	Medical Office	New Baltimore	1988	5/23/2022	26,801	98%	\$166.04	7.91%
5	Macomb Professional Building	Warren	1970	4/14/2022	37,653	90%	\$207.15	5.00%
Indicated Cap Rate Range:							5.00% - 8.99%	
Average (Mean) Cap Rate:							7.30%	

- Survey and National Reports

Capitalization Rate Surveys – Office Properties					
	IRR-ViewPoint	IRR-ViewPoint	PwC	PwC	ACLI
	National	National	2Q-23	2Q-23	1Q-23
	CBD Office	Suburban Office	CBD Office	Suburban Office	Office
Range	5.00% - 9.75%	5.50% - 8.75%	4.25% – 7.50%	4.30% – 8.00%	NA
Average	7.00%	7.18%	5.88%	6.30%	6.18

Source: IRR-Viewpoint 2023; PwC Real Estate Investor Survey; American Council of Life Insurers Investment



Annual Net Income: \$550,000  
Sold For: \$6,200,000  
  
Cap Rate =  $\$550,000 / \$6,200,000$   
= **8.87%**



Annual Net Income: \$127,000  
Sold For: \$2,200,000  
  
Cap Rate =  $\$127,000 / \$2,200,000$   
= **5.77%**

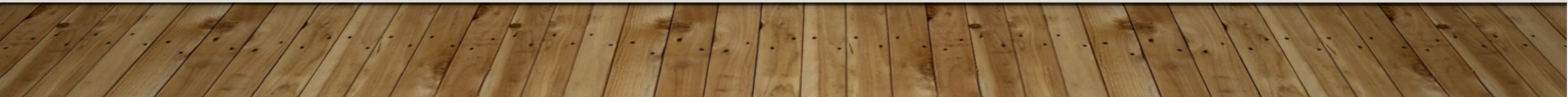


NOT ALL PROPERTIES HAVE A  
CAP RATE





INCOME  
PRODUCING  
PROPERTIES DO  
HAVE CAP RATES



# CAP RATE RELATIVE TO VALUE

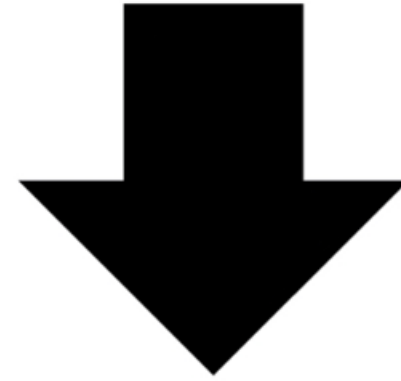
Decompression



Cap Rate

Value

Compression

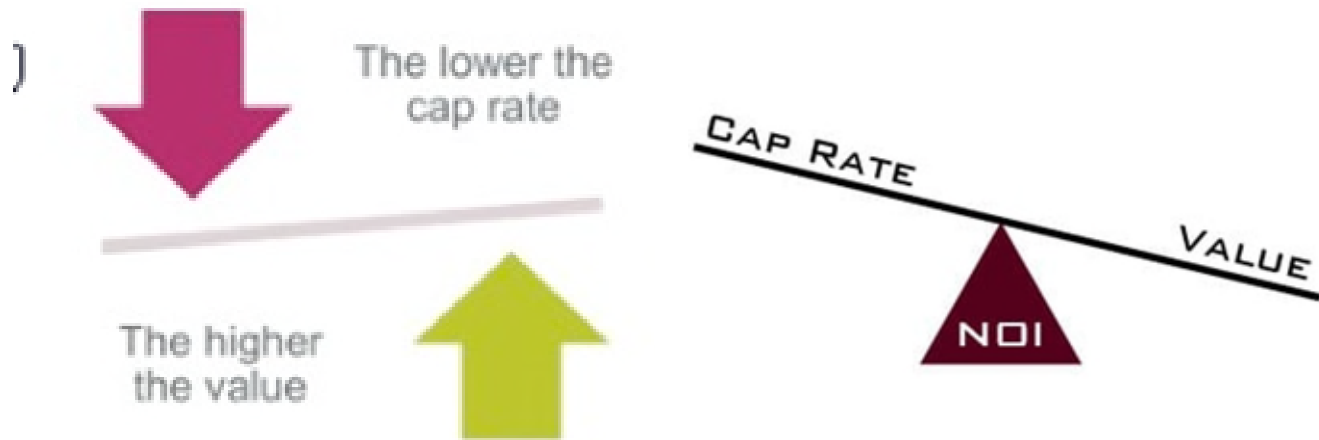


Cap Rate

Value

# CAP RATE RELATIVE TO VALUE

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# DO WE WANT HIGH OR LOW CAP RATE RATE?

DEPENDS ON THE PERSPECTIVE  
(BUYER VS SELLER)

The lower the cap rate – the higher the property value

The higher the cap rate the lower the property value



# ARE CAP RATES TRENDING UP?

- Increasing cap rates mean lower property values
- Rising interest rates force cap rates up eventually
- Increased market risk and uncertainty drive cap rates up eventually



Net Income Generated	\$100,000
<i>Divided by the rate:</i>	
Cap Rate of 5%	\$2,000,000
Cap Rate of 6%	\$1,666,667
Cap Rate of 7%	\$1,428,571



Q & A