

# THE ORANGE REPORT

YOUR SOURCE FOR KANSAS CITY COMMERCIAL PROPERTY INFORMATION

SECOND QUARTER  
2017

## Finding the "Right Deal" in a World of Change

Debt is easy to come by and partners are waiting with money to invest, but finding the "right deal" has never been harder. Uncertainty surrounding the future of interest rates, the current administration's policies regarding foreign investment, and technological advancements have all changed the way people look at real estate opportunities.

*Where is all this money coming from?*

Real estate prices have rebounded to record highs in nearly all primary and secondary markets while tertiary markets trail closely behind. Advancements in financial technology, the creation of easy to use investment vehicles, and market regulations have increased the accessibility and opportunity for commercial real estate investments.

In addition to increases in domestic investment, the international flow of capital entering the United States is at an all-time high with \$97 billion in 2015 and \$65 billion in 2016. The United States offers attractive yields and strong economic performance when compared to Germany, France, and Japan. This flood of international capital has created a surplus of money for investment grade real estate initially in the primary coastal markets, but the Midwest region and secondary locations also feel the positive impact of the surplus.

Major cities in the northeast, southern California, and San Francisco have been natural targets for international investments. While they still lead in total dollar amounts, deal activity has fallen in Manhattan and Los Angeles, but increased almost 20% in both Dallas and Atlanta. Austin, Nashville, Atlanta, and Denver, for example, have historically taken a backseat to larger metropolitan areas but have recently become popular locations for millennials looking for a lower cost of living and higher quality of life. Although many of these 18-hour cities have recently received the most outside investment in their history, the cap rate delta between the largest metros and non-major metros continues to expand. This delta can be attributed to the risk exposure of overbuilding in less dense secondary markets. As investors continue to search for yield in a low interest world, they will be pushed further from the primary markets and further down the list to secondary and eventually tertiary cities.

*How is debt impacting developers?*

The once dry debt markets of the great recession have reopened their doors for business, giving both business owners and property owners room to grow. Bank assets (in terms of total dollars) have never been higher, yet restrictions continue to hold lenders in check. The development boom of the past few years has started to slow down with banks restricting the amount of loan-to-value they are willing to provide developers. This void in the capital stack has given private investment groups the opportunity to explore the mezzanine debt space. This debt tranche provides liquidity to the market acting as preferred equity anywhere from 65% to 90% loan-to-value at an interest rate that can exceed 12% on riskier projects. Kohlberg Kravis Roberts (KKR) and other private equity groups have filled this gap for developers in the past, but many more groups are looking to copy this strategy. Preqin's 2017 Sovereign Wealth Fund Review cites mezzanine debt as the most attractive instrument over the next

*Continued on the next page.*

Sources: <sup>1</sup>CoStar: Total existing space, for all retail and office types, including direct and sub-lease. Change for Average Vacancy Rate represents the difference between 2016 & 2017- percentages. <sup>2</sup>Preqin as of April 3, 2017 <sup>3</sup>U.S. Census Bureau: Estimated monthly. <sup>4</sup>Creighton Economic Forecasting Group. Survey ranges from 0-100 with a score of 50 considered growth neutral. Under 50 indicates a contracting economy for the next three to six months. Mid-America survey states are Kansas, Missouri, Arkansas, Iowa, Minnesota, Nebraska, North Dakota, Oklahoma and South Dakota. <sup>5</sup>U.S. Bureau of Labor Statistics. Unemployment rates seasonally adjusted. <sup>6</sup>Kansas City Regional Association of Realtors. Average sales price of new & existing homes. <sup>7</sup>Home Builders Association of Greater Kansas City. Total units YTD as of June 2016.

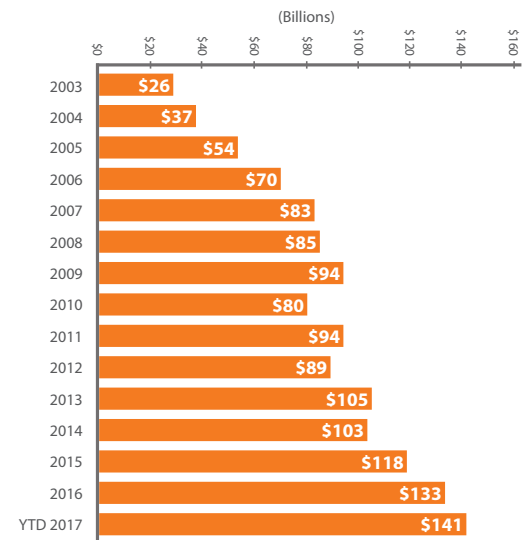
## Kansas City Sales & Leasing Data

KC MSA Shopping Center Retail <sup>1</sup>			
	Q2 2016	Q2 2017	% Chg
Total GLA (s.f.)	132,010,652	132,695,129	0.52%
Avg. Lease Rate	\$12.34	\$13.05	5.75%
Avg. Occupancy Rate	93.20	94.30	1.18%

KC's Largest Lease Signings - 2017 YTD <sup>1</sup>		
Location	Tenant	Size (s.f.)
PraireFire (South Johnson County)	HomeGoods	24,367
The Country Club Shops (NE Vivion Rd)	Undisclosed	21,157
Tiffany Springs MarketCenter (I-29 Corridor)	Tuesday Morning	16,500

Avg. Total MSA Vacancy <sup>1</sup>		
Period	Vacancy Rate	Lease Rate
2017	5.7	\$13.05
2016	6.8	\$12.34
2015	7.0	\$12.40
2014	7.3	\$12.10

## Cash Reserves At All-Time Highs<sup>2</sup>



## National & Regional Trends

Period	U.S. Food & Retail Sales <sup>3</sup> In Billions	Business Conditions Index <sup>4</sup>			
		2017	April	May	June
2017 Q2	\$1,422.3	Missouri	62.4	51	53.8
2016 Q2	\$1,370.4	Kansas	56.4	53.9	56.3
2015 Q2	\$1,334.7	Mid-America			
2014 Q2	\$1,303.1		61.4	55.5	62.3

Period	Unemployment Rate <sup>5</sup>		Consumer Price Index <sup>5</sup>			
	'16	'17	2016	April	May	June
June	4.7	3.9	Midwest	244.5	244.7	245.0
Midwest	4.4	4.9	U.S. City Avg	251.1	262.8	250.9

## Continued....

twelve months. These groups find this strategy especially attractive due to a comparable level of yield the mezzanine lender would have received as an equity investor. In the event the mezzanine lender must take the property back, they now own the same asset at a much lower basis than they would have as an investor. In addition to increased competition, mezzanine debt lenders will have a difficult time deploying funds if the current administration can successfully decrease banking regulations and repeal the Dodd-Frank Wall Street Reform and Consumer Protection Act.

### *How much do interest rates actually matter?*

With cash reserves available to invest in commercial and residential real estate, how much do interest rates matter? Low interest rates have fueled the real estate recovery and many believe low rates have overheated the market. While interest rates move up 25 basis points at a time, cap rates have hardly flinched. Many point to the Federal Reserve's hawkish outlook as the end of this real estate cycle, but that has not been the case over the past twelve months. An increase in borrowing costs must decrease the overall capitalization value of an asset, but interest rates over the last 35 years have been as high as 14% during a time in which cap rates stabilized at 7%. From 2000 to 2007, interest rates rose during a time in which cap rates would decline. The collapse in 2008 was followed by a large increase in cap rates while interest rates dropped. These time periods have shown that cap rates and interest rates do not work in lockstep and there are many factors other than the cost of borrowing that play into real estate investment. The decrease of lending regulations coupled with large amounts of equity waiting to be deployed by domestic Pension Funds and Sovereign Wealth Funds puts us in a position where the supply of money has outstripped the number of good deals to invest in. Regardless of where interest rates are headed, there will be a surplus of money waiting to be deployed across the United States.

Whether investors are looking to hedge against inflation or looking for a tangible asset to avoid a catastrophic market collapse, commercial real estate in the United States remains favorable when the world is in chaos.

*Alex Howe, Associate Broker*

## Giving Back

As a long-time supporter of Heartstrings Community Foundation, LANE4 sponsored their annual fundraising gala, Heartstrings in Bloom. This year's gala was the organization's largest event yet, and the silent auction raised funds at an all-time high! LANE4 has been involved with Heartstrings for eight years and continues to use their Goody Delivery® service, a mobile snack service that sends a trained sales team directly to the office with a cart of various affordable treats to enjoy.

Heartstrings Community Foundation is a non-profit 501(c)(3) organization that provides opportunities for adults with intellectual/developmental disabilities to live independent lives through successful employment and interaction within their community. For more information or to join the Goody Delivery Program, please visit [www.heartstringscf.org](http://www.heartstringscf.org).

## About LANE4 Property Group

LANE4 provides its clients the best position from which to succeed. The firm offers an advantage in tenant representation, project leasing, property management, investment sales, receivership, project management, and development. These comprehensive services allow our clients to streamline their time and optimize their investments. From the initial market analysis through the grand opening and operation, the team at LANE4 executes each step of the process with skill and professionalism.

Our team has forged strong relationships with our constituents: tenants, investors, municipalities, architects, engineers, attorneys, contractors, and developers. This experience, dedication, and focus – combined with creativity and passion – is the LANE4 formula that maximizes our partners' results.

## Kansas City Housing

Average Home Price <sup>6</sup>			
County	June '16	June '17	% Chg
Cass County, MO	\$230,258	\$231,852	0.7%
Clay County, MO	\$198,775	\$213,171	7.2%
Jackson County, MO	\$185,029	\$194,881	5.3%
Platte County, MO	\$237,496	\$287,627	21.1%
Johnson County, KS	\$314,318	\$337,505	7.4%
Leavenworth County, KS	\$191,883	\$213,061	11.0%
Miami County, KS	\$210,672	\$205,610	-2.4%
Wyandotte County, KS	\$147,988	\$139,863	-5.5%
<b>Kansas City Region</b>	<b>\$229,159</b>	<b>\$241,567</b>	<b>5.4%</b>

Residential Building Permits-YTD <sup>7</sup>			
County	June '16	June '17	% Chg
Cass County	256	320	25%
Clay County	673	664	-1%
Jackson County	1,157	1,140	-1%
Platte County	610	274	-55%
Johnson County	1,704	1,390	-18%
Leavenworth County	127	124	-2%
Miami County	46	242	426%
Wyandotte County	117	58	-50%
<b>Kansas City Region</b>	<b>2,793</b>	<b>4,212</b>	<b>51%</b>

## For. Your. Information.



LANE4 recently welcomed Bob Rummans to its team.

Bob is the latest addition to the accounting department. As LANE4's new Controller, Bob assists a great staff of accountants, property managers, and brokers as LANE4's portfolio continues to expand.



**XTEAM**

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