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National

FTI's Hedden: This Time is Different

NEW YORK CITY—A combination of three factors makes a real estate investment "attractive in this market," says Michael P. Hedden at FTI Consulting.

By Paul Bubny

NEW YORK CITY—A recent article in FTI Consulting's *FTI Journal* posed the question, "The state of the US real estate market as an investment vehicle shows eerie similarities to the era before the Great Recession. Should we be worried?" The firm's Michael P. Hedden, managing director with FTI's real estate solutions group, provided assurances that this wasn't the case. "While we are at the same point in time on the trend curve for sales volume and capitalization rates," he said, "the facts and circumstances indicate solid fundamentals and abundant liquidity are being strategically deployed."

GlobeSt.com spoke with Hedden for his insights on why it's different this time around, what lessons investors learned from the Great Recession and why the presidential election won't make a significant impact in the near term.

GlobeSt.com: Compared to the run-up to the capital markets crisis of the previous cycle, what are some similarities and differences?

Michael P. Hedden: The similarities that are pointed out in the press and in some of the data are the continuing increase in pricing for core assets in gateway markets, and the compression of cap rates, resulting in price levels that exceed what we saw in the 2007 time frame. Because of the fear and the memories of market participants from the precipitous

Hedden sees the current market as "reflective of sound real estate investment criteria."

crash that occurred in 2008 as part of the Great Recession, questions are raised by participants and the media as to whether we would expect another repricing of these assets in the market. Those would be the similarities.

I see several distinctions in the economy today, and in the real estate market in particular, that would suggest that these times are different and that there is more awareness of the recent past and what caused that run-up in pricing. That's coupled with a new normal in terms of economic fundamentals.

GlobeSt.com: Is the expectation of slower economic growth helping to keep things from getting overheated?

Hedden: We are in a slow-growth environment, but also a low interest-rate environment globally. Low growth also means low inflation. These factors combined make a real estate investment attractive in this market. What you add to that mix is the ability to have a return on a real estate investment that is better than CPI and better than inflation, and when you're disciplined and underwrite the transaction correctly, it's a good place to make your capital investment.

There are two things that are continuing to suggest that we're not in a bubble or having irrational exuberance. One is discipline. Lenders are more disciplined from the debt side, there's not too much leverage entering the marketplace and the risk is primarily on the equity investor. Before, much of the downside risk for the real estate value was borne by the holders of the mortgage or the debt. Here, lenders are being more conservative and showing more restraint. It's the equity investors that are taking more of the risk.

The other thing that's indicative of a very attractive market is that smart investors and pension funds are all allocating a lot of money to real estate investments, and you have a lot of dry powder, a lot of investment capital seeking investments at this time and going into more secondary markets where growth can be anticipated. That's reflective of sound real estate investment criteria where you have disciplined debt and investors that are analyzing fundamentals in the marketplace and are being very cautious in their investments.

GlobeSt.com: Did investors learn some lessons from the previous cycle?

Hedden: Absolutely. What they learned is that when they're underwriting transactions in prime markets, the criteria that they use to analyze those transactions don't apply uniformly when you look at secondary or tertiary markets. Investors learned that the economic principles of investing in gateway cities do not apply to Middle America. They're more cognizant of that now, but they also benefit from greater transparency with data analytics.

With the advent of data sources and better computer tools, investors can better understand the dynamics of these other markets in real time, given better analysis than was available eight or nine years ago. We've come a long way; you have Real Capital Analytics, CoStar, Reis and all of these other sources to help investors and keep them abreast of current market information. Therefore they make smarter decisions.

GlobeSt.com: The* FTI Journal *article was published prior to the presidential election and its unexpected outcome. Do you see the new administration having an impact that will be immediately noticeable?

Hedden: It's glacial. It's going to change from a very long-term perspective. The tenets of the article were about the availability of capital, disciplined investment and the ability of big data to analyze, in real time, the movements of those dollars and the activity in the markets. None of that has changed in the past month or two; as it unfolds over the next year or two, we'll see if capital flows and foreign investors—who still see the United States as a premier investment opportunity, compared to the world economy—undergo any changes. The big impacts in the future will be on trade and currency pricing relative to the larger global economy, and that will evolve over the next 12 to 24 months.

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