

Win or lose, Super Bowl XLIX kept us guessing down to the final seconds of the game. Predicting markets is not much different, but for real estate investors we still find it important to have a view. While we still have plenty of time to be proven right or wrong, here are Park Madison’s top 10 market predictions for 2015:

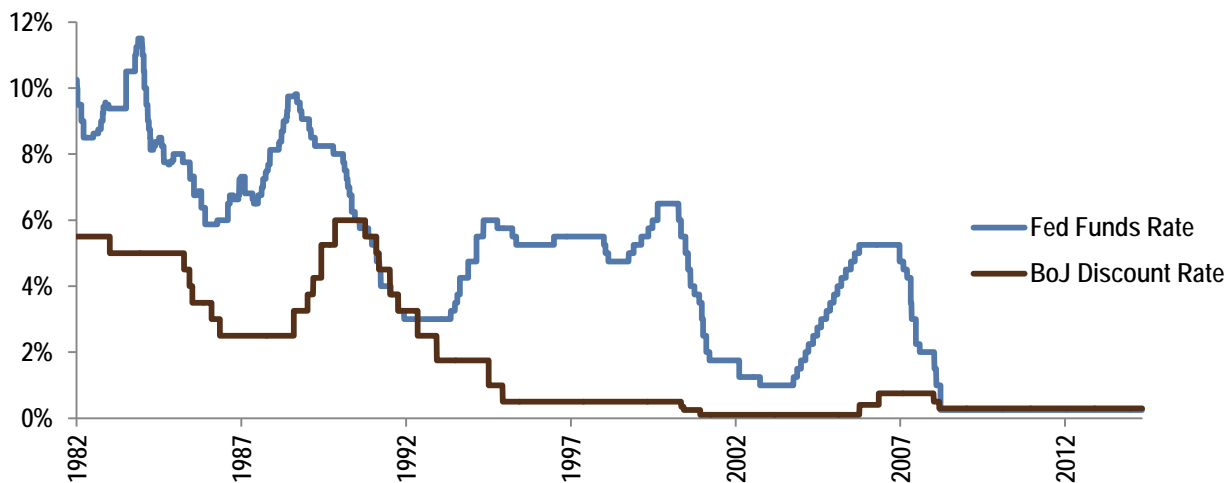
1. The Fed will remain accommodative, keeping policy rates near historical lows
2. US 10-year Treasury yields will approach 3%
3. US real estate will offer interesting opportunities across the risk spectrum
4. Fundraising will gain momentum, and deal sourcing will become more competitive
5. Technology will continue to transform the real estate industry in unpredictable ways
6. A weak Euro and a dovish ECB will create opportunities in Europe
7. Oil will not rise above \$70 per barrel
8. Emerging markets will start to find a cyclical bottom
9. New York’s condo market will soften
10. And last but not least... Nearly everyone will run for President

**OUTLOOK 2015**

**The Fed will remain accommodative**

After 6 years of zero interest rate policy (“ZIRP”), we anticipate that the US Federal Reserve will finally hike interest rates, albeit very slowly and in small increments. At most, we see a 0.25% Fed policy rate by summer, and perhaps 1.00% by year-end. With the entire developed world suffering from low inflation and even threats of deflation, the Fed should be in no hurry to normalize policy. One of the biggest mistakes Japan made after its market crash in the early 1990s was to hike rates prematurely, thereby throwing the country back into recession and prolonging the pain. As we look at Japanese policy rates versus Fed policy since 2008, we might wonder if there is a lesson to be drawn from history. Is the US turning Japanese? We don’t really think so... But just to be sure, we believe the Fed will remain more accommodative than the current pace of GDP and employment growth would lead markets to believe.

**Turning Japanese? – Fed Funds Target Rate vs BoJ Discount Rate, Jan 1982-Jan 2015**



Source: FRED Economic Data, Bank of Japan

## US 10-year treasury yields will approach 3%

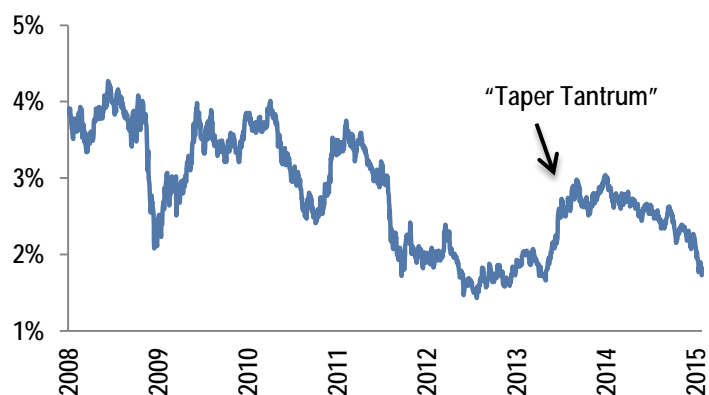
At the beginning of 2014, approximately 95% of attendees at any given real estate conference thought that Treasury rates were heading higher over the next year. After all, rates had already spiked in the latter half of 2013, which many attributed to the Fed's "taper talk". So with economic growth accelerating and the Fed on course to normalize policy, higher interest rates seemed all but assured.

The reality could not have been further from the truth. Rates on 10-year Treasuries, after testing the 3% line towards the end of 2013, began a nearly uninterrupted descent to sub-2% levels. At the time of this writing, the rate on 10-year Treasuries is 1.67%. Such a drastic decline in rates would normally imply disaster looming for the US and world economies. This view seems to be corroborated by plunging oil and commodity prices, low inflation, and a renewed flare-up of uncertainty in the Eurozone. However, the economic outlook in the US looks very positive. Unemployment is falling, wages are rising, and 3Q 2014 GDP growth clocked in at a dizzying 5% annual pace. Where is the fire?

As such, we believe bond market's message is not one of impending doom. A more likely explanation for low rates in the US seems to be a combination of falling inflation expectations in the developed world and capital flight from other countries, particularly emerging markets and the Eurozone. A strengthening US Dollar might also be driving demand for dollar-denominated assets such as Treasuries. European investors, for instance, may be indifferent about interest rates if they can earn 15-20% from the currency move alone. With Japan and the EU both using quantitative easing to weaken their currencies and fight deflation, "King Dollar" becomes the default safe haven currency of choice.

As such, we believe that normalizing Fed policy and strong US economic fundamentals are not guarantees of rising interest rates in 2015. Increasingly, local economies are driven by global forces, and we believe economic improvement in Europe and emerging markets will play an important role in directing the path of interest rates in the US for the foreseeable future. We do not expect the rate on the 10-year to rebound much higher than the 3% level in 2015.

Stubborn Trends – US 10-Year Treasury Rates, Jan 2008-Jan 2015



Source: FRED Economic Data, Athens Stock Exchange

## US real estate will offer interesting opportunities across the risk spectrum

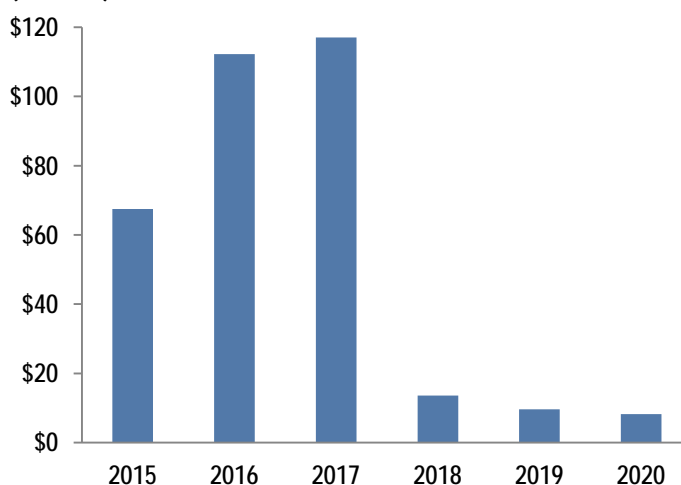
Within the real estate community, expectations of rising interest rates have led many to speculate that rising cap rates will soon follow. In the context of buying Class-A office in Manhattan at a 3% cap rate, this may indeed be cause for concern. However, if history is any guide, rising interest rates do not spell doom for real estate valuations, as rising interest rates are generally indicative of a strong economy, and with it NOI growth. Additionally, US cap rate spreads over 10-year Treasuries – approximately 400-450 bps on average throughout 2014 – compare favorably to long term averages and should soften the impact from rising rates. While we expect any rise in cap rates to be modest, we maintain that the best hedge against rising cap rates is prudent underwriting. Managers who exercise this caution should continue to outperform over the long run.

We also expect more investors to begin venturing into non-major markets in 2015 to exploit the relative value opportunity versus major markets. Moody's and Real Capital Analytics estimate that since January 2010, major markets (consisting of Boston, Chicago, Los Angeles, San Francisco, New York, and DC) have appreciated by approximately 89%, versus a 57% increase for non-major markets. While this differential is justified by the faster pace of economic recovery in major markets, we expect non-major markets to start catching up as the benefits of US growth are shared more broadly.

Speaking of valuations, an interesting trend we have seen in the past 6-12 months is a growing number of institutional investors looking at real estate senior debt strategies. Two forces appear to be driving this appetite: (1) a hunger for yield as interest rates have declined across the developed world, and (2) concerns about valuations and a corresponding desire for investments with downside protection. As valuations continue to creep higher, finding the best risk-return tradeoff is likely to grow more challenging, and many investors are likely to see debt as an attractive alternative to core and value-add strategies.

Of particular note in 2015, we will finally reach the CMBS "maturity wall" that we have all heard so much about. Approximately \$300 billion of CMBS will come due from 2015-2017, a 250% increase from the 2012-2014 period. These loans were mostly originated at the peak of the last cycle in 2005-2007. The good news is that markets and asset values have recovered in recent years, and many of these loans should have no problem getting refinanced. Some, however, will require additional capital as the property values are still underwater. This is especially true for the loans issued at the peak in 2007, which often entailed aggressive property valuations and LTVs of 80% or higher. We expect this will create some interesting deal flow for opportunistic and value-add managers over the next 3-4 years.

**Hitting the Wall – CMBS Maturity Schedule, 2015-2020 (Billions)**

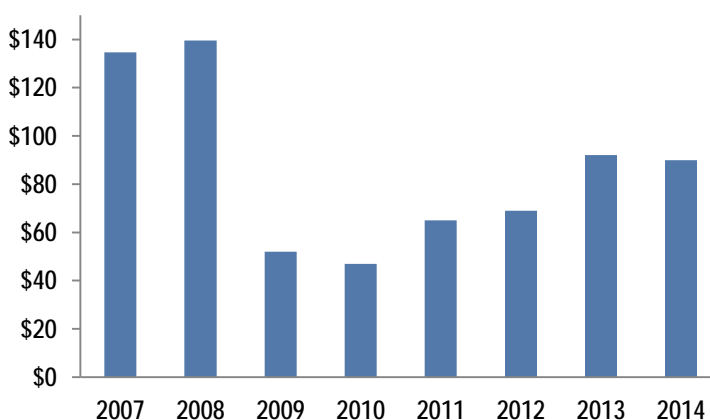


Source: Wells Fargo Securities

**Fundraising will gain momentum, and deal sourcing will become more competitive**

2013 and 2014 were the best fundraising years for real estate since the Global Financial Crisis, with approximately \$90 billion of equity raised in both years. This momentum looks set to continue in 2015. After a brief period when some were questioning real estate's role in institutional portfolios, Preqin data shows that real estate delivered higher returns than both private equity and venture capital funds in the year through March 2014. Institutions are on average about 2% below allocation – 7.6% allocation versus a 9.6% target – suggesting more capital will be put to work in the sector over the next several years.

**Still Climbing Back – Real Estate Closed-End Fundraising, 2007-2014 (Billions)**



Source: Preqin

Large-cap funds in particular have been attracting record amounts of capital, which looks set to continue in 2015. Blackstone, for example, is currently in the market targeting a \$15 billion raise for Blackstone Real Estate Partners VIII, and rumor has it that the fund will have an unprecedented \$10 billion first close in March. While this is good news for the asset class, it may have a certain “crowding out” effect for middle-market and emerging managers, as we saw when Blackstone corralled \$13 billion for BREP VII. So while 2015 could be a good year for fundraising, expect the process to remain competitive as ever for most managers.

In addition to new capital being raised, data from Preqin suggests there is approximately \$221 billion of dry powder in real estate private equity funds. As such, we expect competition for deals to be the fiercest it’s been since the Global Financial Crisis. With so much capital to invest, we also expect to see some interesting “mega-deal” activity, and even a large REIT buyout seems within the realm of possibility.

### Technology will continue to transform the real estate industry in unpredictable ways

Real estate has historically managed to keep itself fairly insulated from ground-shaking technological innovations. Just consider the materials and process used to construct a single family home in the United States today versus the 1950s. We are a true bricks and mortar industry, after all. However, the past few years have seen some real technological innovations start to enter the real estate industry, and many of them are poised to thoroughly disrupt the status quo.

Big data is a prime example. Real estate has traditionally been characterized by its informational asymmetry, thereby providing those who are “in the know” with a distinct competitive advantage. Big data threatens to upend some of this. Several new innovative firms are leveraging online resources to analyze data and provide brokers, investors, and managers with information that they can access quickly to make informed decisions. Zillow and Trulia, once the merger is complete, will control approximately 48 percent of all online listing traffic. The implications of such a large data mine are difficult to predict.

Additional start-ups are continuously emerging to create further data efficiencies in real estate. In New York, we have seen companies such as Compstak, View the Space, 42 Floors, Honest Buildings, RealConnex, and Reonomy gain significant momentum. According to a report from RE:Tech, over \$700 million has been invested globally into real estate technology start-ups between Q2 2012 and Q2 2014.

Another technological innovation driving further democratization of real estate is crowdfunding. For retail investors, the access and freedom of choice that crowdfunding platforms provide are clearly appealing. Fundrise, for instance, just launched a fundraising round on Class 1 senior secured bonds for 3 World Trade Center, providing retail investors the opportunity to invest directly in one of Manhattan’s most high profile development projects. Similarly interesting transactions are likely to emerge over the next year as the trend catches on.

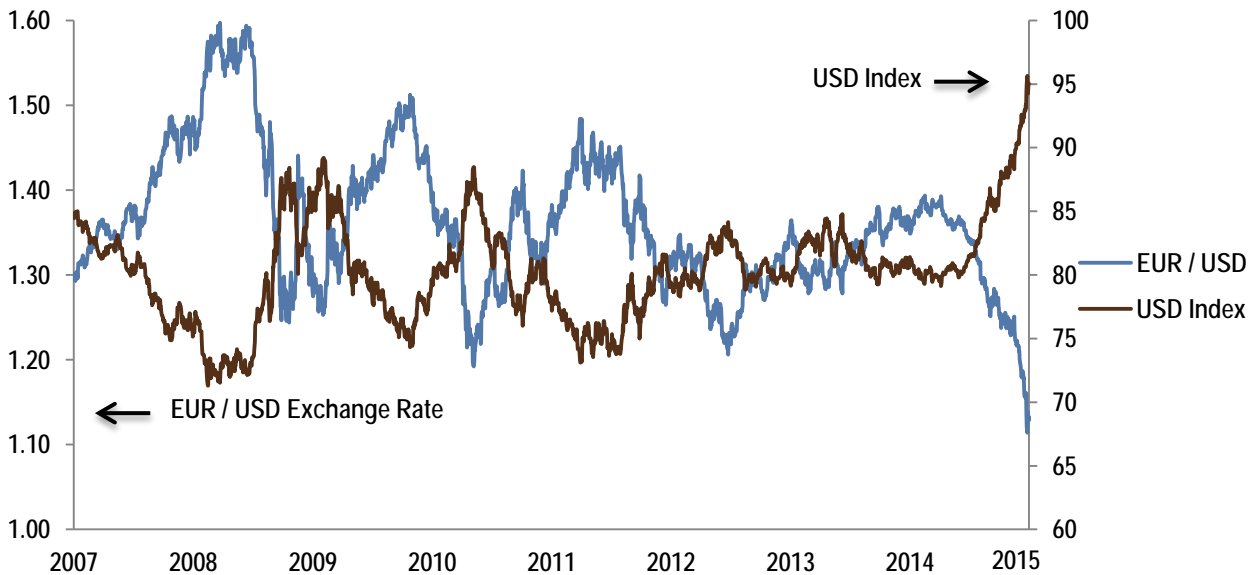
Crowdfunding does raise questions about suitability and investor education. It will be interesting to see how some of these new platforms and their investors weather the first downturn, as well as the new regulatory scrutiny that will surely follow. In the meantime, however, the momentum is clearly in favor of real estate crowdfunding. So while we cannot yet say for sure how this relatively new phenomenon will change the fundraising business, we believe crowdfunding is here to stay and will play an increasingly important role in real estate capital markets.

### A weak Euro and a dovish ECB will create opportunities in Europe

2015 is already shaping up to be a year of wide divergence in monetary policies between the US and Europe. With the ECB having just announced the launch of its €1.1 trillion quantitative easing program, and the Fed expected to finally hike interest rates this year, we are likely to see the Euro continue to weaken against the dollar. Eurozone politics will also have an impact. At the time of this publication, the radical-left coalition Syriza has just won elections in Greece, raising the prospect of “Grexit” from the Eurozone to its highest probability since 2012. Anti-austerity parties in other EU countries are also seeing rising poll numbers. To date, throughout the EU’s sovereign debt crisis, the world has breathed a sigh of relief as “cooler heads” have prevailed. The odds of this lucky streak continuing are growing longer, and markets are likely to reflect the increased uncertainty.

As such, parity between the US dollar and the Euro – once unthinkable – now seems firmly in the realm of possibility. Ultimately, we view a weak Euro as a positive development for the Eurozone, as a weaker Euro will help stimulate exports and tourism in the Eurozone’s recession-struck periphery. Investors will also be attracted by low Euro valuations as a positive entry level for long term investments. This would be a potential boon to much-needed infrastructure investment across the continent. Real estate investors may also see this as an attractive entry point, especially in markets that appear to have hit a cyclical bottom. Spain, for instance, has enacted aggressive structural reforms and returned to economic growth; office rents in Madrid have stabilized after falling 40-50 percent from the peak. More investors are beginning to venture into Italy as well. Assuming the Eurozone can avoid a disorderly exit by Greece or any other member states, we believe 2015 will offer some compelling opportunities for long-term investors in the region.

**Return of King Dollar – EUR / USD Exchange Rate vs USD Index, Jan 2007-Jan 2015**



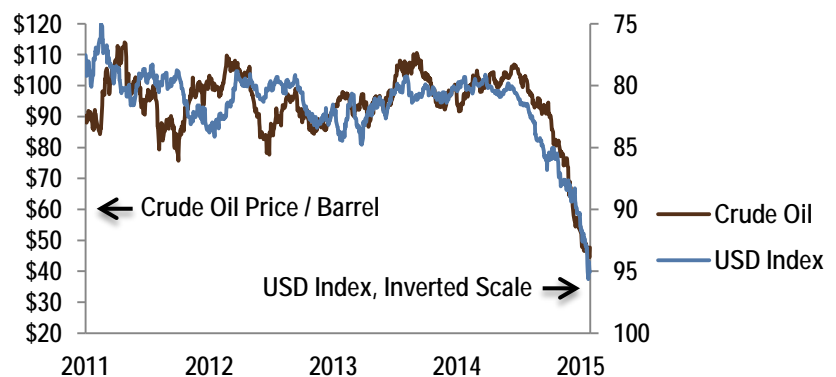
Source: Bloomberg

**Oil will not rise above \$70 per barrel**

Oil prices were perhaps one of the biggest market surprises of 2014. A combination of supply glut, global growth concerns, and a strong dollar conspired to send oil prices plummeting. If prices remain suppressed, supply destruction is sure to follow as expensive exploration projects are deemed unprofitable. Several major oil exploration companies have already announced planned reductions in capex over the next year. While a rebound from current levels seems likely simply given the magnitude of the recent decline, we would not expect oil to rise above \$70 per barrel in 2015.

In the meantime, we expect a period of consolidation in the US energy industry, including bankruptcies for smaller companies with high exploration costs. How this will affect real estate values in energy-related markets such as Houston remains to be seen. Regardless, we believe the American shale revolution is here to stay, and any period of distress will likely prove to be a good buying opportunity.

**Down the Well – Crude Oil vs US Dollar Index, Jan 2011-Jan 2015**



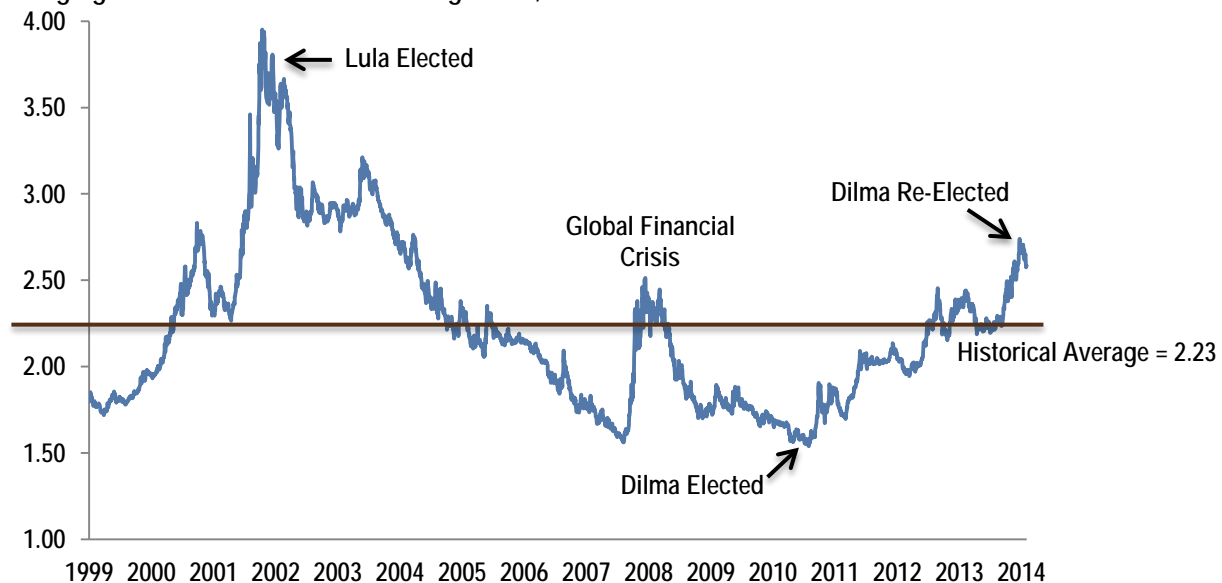
Source: Bloomberg

## Emerging markets will start to find a cyclical bottom

After leading global GDP growth following the 2008 financial crisis, emerging markets have been generally out of favor with investors since 2012. Each of the BRICs countries has been coping with its own unique set of problems. China's rate of growth has been slowing. Russia has suffered from geopolitical tensions and falling oil prices. Brazil has experienced sub-par economic growth and currency depreciation as its government has practiced loose fiscal management and populist economic policies. India is in dire need of structural reforms. Other emerging markets are similarly challenged, and for many of them recent declines in commodity prices have not helped. For fund managers focused on these regions, the past several years have been a long winter.

However, we anticipate that 2015 will see a cyclical bottom in investor sentiment towards most emerging markets. China and India already appear to have turned a corner. China's CSI 300 stock market index rallied +52% in 2014, and India has just cut interest rates as inflation returns to manageable levels. Brazil also looks promising, as the Rousseff administration shifts towards a more pragmatic strategy of economic management following the 2014 presidential election. As such, we believe 2015 will see more investors returning to select emerging markets to take advantage of weak currencies and potential cyclical bottoms. Expect to hear more commentary about "down-cycle investing" as the year progresses.

### Emerging Distress – BRL / USD Exchange Rate, Dec 1999-Jan 2015

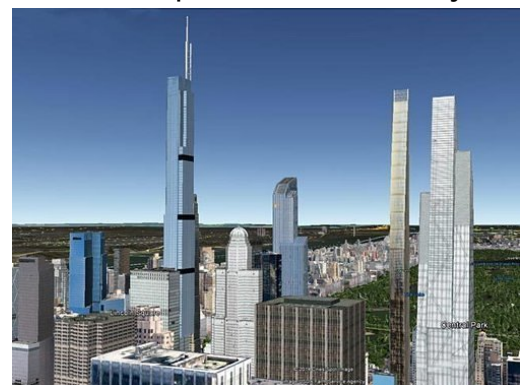


Source: Bloomberg

## New York's condo market will soften

To give a view on matters in Park Madison's own backyard, one real estate market that looks set to slow down in 2015 is the New York condo market. After years of breakneck construction, the market is already showing real signs of softening. Condo listings are expected to hit an all-time high this year – doubling 2014's total – just as foreign buyers are seeing their purchasing power diminish in the face of a strong dollar. Brokers are beginning to remark about how listing periods are growing longer. Particularly telling is the level of unsold inventory at Extell's One57, which began sales in 2011 and remains approximately 25% unsold as of September 2014. With a flurry of other high-end condo projects nearing completion, simple supply-and-demand economics paints a challenging picture.

### Race to the Top – 57<sup>th</sup> Street Future Skyline



Source: NY YIMBY, Rendering by Armand Boudreaux

## Nearly everyone will run for President

Finally, with the vitriol of the 2014 midterm elections behind us, it is time to breathe a collective sigh of relief and instead focus our attention on... 2016 elections! Expect speculation about potential 2016 presidential runs to hit a fever pitch by this summer. Current polling suggests that Hillary Clinton is by far the favorite to win the Democratic nomination, leading the rest of the pack by approximately 50 points. This should keep the field of Democratic contenders fairly limited, as donors and volunteers flock to the presumptive nominee. The Republican nomination, on the other hand, is completely wide open with no clear frontrunner in sight. Only one candidate, Jeb Bush, is even polling above 10% currently. If 2012 was a contentious nomination process for the GOP, 2016 looks to be even more challenging. Speculation of a brokered convention – last seen in 1920 – is already swirling. We expect no fewer than 20 Republicans will declare their intention to run. New York real estate's very own Donald Trump will not be among them, but he will surely do his best to convince us otherwise.

### A Wide Open Field, and Hillary – US Presidential Nomination, RCP Average of Polling Data, 1/27/15

| Republican Candidates* | Current Polling | Democratic Candidates* | Current Polling |
|------------------------|-----------------|------------------------|-----------------|
| Jeb Bush               | 16.4%           | Hillary Clinton        | 60.0%           |
| Chris Christie         | 9.4%            | Joe Biden              | 11.4%           |
| Mike Huckabee          | 9.0%            | Elizabeth Warren       | 11.1%           |
| Rand Paul              | 8.6%            | Bernie Sanders         | 3.4%            |
| Ben Carson             | 8.4%            | Andrew Cuomo           | 2.5%            |
| Scott Walker           | 5.8%            | Jim Webb               | 1.6%            |
| Ted Cruz               | 5.2%            | Martin O'Malley        | 1.1%            |
| Marco Rubio            | 4.6%            | Other / Undecided      | 8.9%            |
| Rick Perry             | 4.2%            |                        |                 |
| Bobby Jindal           | 2.8%            |                        |                 |
| John Kasich            | 2.4%            |                        |                 |
| Rick Santorum          | 2.4%            |                        |                 |
| Other / Undecided      | 21.8%           |                        |                 |

Source: RealClearPolitics.com average of polls, week ending 1/27/2015.

\*Candidates are based on hypothetical polling based on potential candidates. Most candidates named have not formally declared their intention to run for President. Park Madison Partners has not endorsed any candidates for public office and does not provide support to any political parties or organizations.

## ABOUT PARK MADISON PARTNERS

Park Madison Partners is a New York-based real estate placement and advisory firm focused on the global real estate private equity and private funds industry, and to date has participated in the placement of over \$6 billion of real estate capital globally. Park Madison Partners was founded to offer clients capital raising and strategic consulting services with a high degree of customization, integrity and accountability. The firm provides a relationship-driven approach to structuring and marketing assignments and offers its clients access to institutional investors across North America. Park Madison Partners is a member of SIPC-FINRA and is certified with the Women's Business Enterprise National Council.

For further information, please visit [www.parkmadisonpartners.com](http://www.parkmadisonpartners.com).

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