PCCP Market Commentary

Headlines Don't Tell the Whole Story

Fourth Quarter 2017

While the use of propaganda dates back to ancient times, this past year "fake news" and other forms of propaganda have been at the center of the national conversation. An essential technique of fake news is the use of headlines written to attract "clicks" that may not tell the complete story, or may even mislead the reader. This technique relies on many readers' willingness to draw conclusions based on a headline, rather than gathering all of the data available and coming to an informed, thoughtful conclusion. In fact, a recent study found that the recipients of 59% of articles shared on social media never opened the full article, leaving them open to being misled or misinformed by headline content.

This phenomenon is a serious issue in the political sphere. Should we also be concerned about it in real estate market news media as well?

The answer is yes! We have found that the headlines in real estate coverage mirror this disturbing trend, and have the potential to misinform real estate investors.

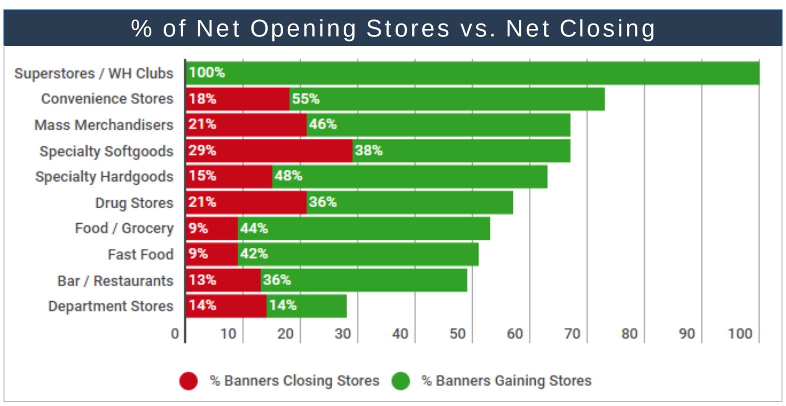
Headlines vs. Reality

	The Headline	The Reality
Retail	"Store closings have tripled so far this year"	Store openings are expected to outpace store closings by over 4,000 in 2017
Sales Volume	"Sales down 8% overall; CBRE leads at half"	Excluding New York City (down 55% Y-o-Y), national sales volume is up.
Multifamily	"Millennials flock to cities" (boosting CBD fundamentals)	Vacancy in CBDs is nearly double vacancy in the Suburbs
Real Estate Lending	"CMBS Delinquencies are down below 4% for the first time since 2009"	Delinquencies are down overall, but office delinquencies are up 50% since 2015

Source: CNN Money; Real Estate Alert (August 8th, 2017); Wall Street Journal; CNN Money; Commercial Mortgage Alert (September 8th, 2017); Wall Street Journal

Set forth below are four areas where we believe the headlines and media narrative in today's real estate coverage do not accurately indicate the facts in the underlying markets, and do not provide a complete picture of the economic landscape. These examples illustrate the critical need to dive deep into facts behind a story, reference multiple sources and draw informed conclusions before making investment decisions.

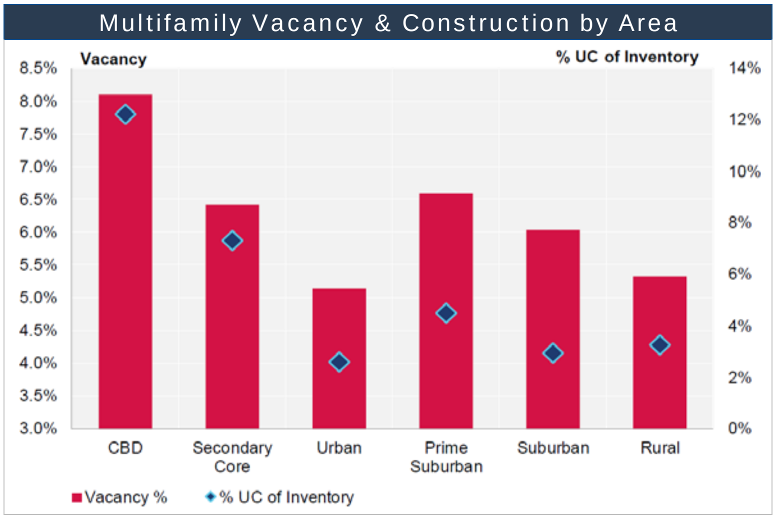
- ***"Store Closings Have Tripled This Year"***. Many national news publications have featured the struggles of brick-and-mortar retail, and the number of household names shuttering stores, in their recent headlines. This is surprising when you consider that domestic retail sales are **up 4.2%** year over year, and **90%** of all retail sales still occur in a physical retail location. The store closure statistics cited are accurate, but store openings this year are actually expected to outpace store closings by over 4,000 openings (or, 2.7 store openings for every store closing). Large shopping center vacancies and regional malls in decline dominate the headlines, but a dig into the details of the closures reveals that not all types of tenants have been affected by store closings. In fact, clothing and fashion-related stores make up the bulk of the closings, while convenience and discount stores have been adding stores. The headlines would lead you to believe that a significant portion of today's physical retail will be replaced by e-commerce. We believe retail presents a compelling opportunity for developers and landlords who provide creative shopping solutions to tenants and consumers in this transitioning but expanding businesses segment.



Source: National Retail Federation

- ***"National Investment Sales Volume is Down".*** Recent national investment sales headlines warned that volume across the five major property types was down over 8% in H1 2017 from the same period last year. While this is technically true, the sales volume reporting is skewed by a significant decrease in transaction activity in New York City, which was down more than 55%. If the New York market is excluded, sales volume was actually **up more than 1.8%** from H1 2016. The New York market is the largest volume driver in the country and an important indicator. But, taking the headline at face value might lead an investor to believe that demand for real estate assets throughout the country is in decline, when in reality, outside of New York City, sales volume and investor demand remains strong.

- ***"Millennials Flock to City Centers".*** Recent headlines trumpet millennials' continuous mass movement to urban locations. These headlines suggest that real estate fundamentals in Central Business District (CBD) locations are likely to outperform suburban areas. While the headlines follow a well-known narrative, we believe the underlying data tells a different story. As shown in the chart to the right, CBD vacancy across the country is significantly higher than suburban vacancy. This is primarily a result of new construction, which is currently at a very high 12% of existing stock in the CBD versus less than 4% of existing stock under construction in suburban locations. Furthermore, a recent study from the U.S. Census Bureau determined that, in fact, millennials are 30% more likely to move from urban locations to suburban locations than vice versa.



Source: CoStar Portfolio Strategy, Analysis limited to 54 major U.S. metros

- ***"CMBS Delinquencies are Down".*** A quick perusal of commercial mortgage-backed security headlines would give you the impression that CMBS loans are performing better than ever, with lower advance rates and lower delinquencies. While this is true for most assets, there are still massive losses occurring on CMBS loans on distressed assets. This is especially true for office and retail assets, which have seen a sharp rise in delinquencies to over 6% of the outstanding, Fitch-rated, CMBS loans.

As these examples indicate, real estate headlines may grab your attention, but they do not always reflect the underlying economic reality. In every market and every property type there are opportunities for those who are creative, who are willing to think outside the headline, and willing to work hard to find them. Just as we wouldn't rely solely on a desktop underwriting, by spending time with our investment partners and market participants in their local markets we can develop a view on how an investment might perform – you can't get that from an article, no matter the headline.

SOURCES: Social Clicks: What and Who Gets Read on Twitter?; CNN Money; Real Estate Alert (August 8th, 2017); Wall Street Journal; Commercial Mortgage Alert (September 8th, 2017); Forbes.com; CBRE, "U.S. Retail Beyond the Headlines"; National Retail Federation; Real Estate Alert (August 8th, 2017); Commercial Mortgage Alert (September 8th, 2017); Forbes.com; CoStar Portfolio Strategy; The New York Times; Our thanks to PCCP's Matt Cochran for his help in drafting this quarterly newsletter.

Bryan Thornton
bthornton@pccpllc.com
(415) 732-7649

Greg Eberhardt
geberhardt@pccpllc.com
(310) 414-2004

Steve Chase
schase@pccpllc.com
(646) 308-2101

K.C. Kriegel
kkriegel@pccpllc.com
(646) 308-2102