VIRTUS
REAL ESTATE CAPITAL

Virtus Real Estate Capital: 2019 U.S. Real Estate Market Outlook

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Lofty valuations, recent market volatility and rising concerns over the probability of recession in the coming years are keeping most investors on their heels as they head into 2019. Economic indicators remain generally positive, but much of that may still be driven by the obscene amount of liquidity pumped into the money supply coming out of the Global Financial Crisis ("GFC"), which has arguably propped up earnings, capital markets performance and economic drivers. This has led to the second longest bull market in history, and many are wondering if there's fuel left in the tank for 2019 and beyond.

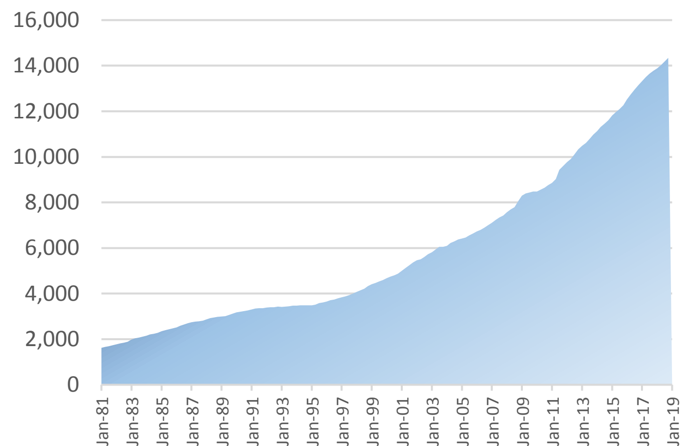

Figure 1: Source - Federal Reserve Economic Data ("FRED")

While monetary levers may have all been pulled in this cycle and quantitative measures have transitioned from easing to tightening globally, accommodative fiscal policies may send the expanding economy into extra innings. We likely haven't yet felt the full effects of the Tax Cuts and Job Act signed into law in December of 2017. Needless to say, reductions in corporate tax rates and deductions in certain income streams, including those generated by real estate investments, means more liquidity available to invest in risk assets and better after-tax performance, all things being equal. In particular, the recent regulations released by the Treasury Department on the Opportunity Zones program could further decrease tax liability from gains investors have experienced in the roaring bull market of the last decade and likewise drive further investment into real estate opportunities, at least in Qualified Opportunity Zones (for a contrarian view on Opportunity Zones, see our recent paper: [Assessing the Opportunity](#)). It's important to note that the views herein relate to commercial real estate and not individual residential homes, which are not really all that correlated to investment real estate performance, excepting the rise of single family residential or SFR as an institutional asset class.

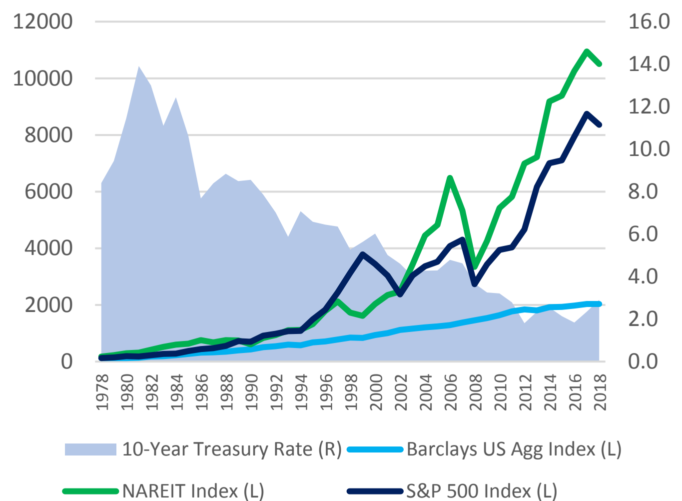

Figure 2: Source- Morningstar and FRED

As I travel the globe meeting with investors of all kinds, I'm struck by the level of confusion even the most sophisticated institutional investors have when thinking about how best to allocate capital. It's hard to blame

them, when many of the market pundits are predicting a "net neutral" year in 2019. Even recent capital markets performance leaves investors second guessing. After 2018, when 90% of risk asset classes were negative and capital markets seemed to be cratering in the 4th quarter, the equities markets have come roaring back in early 2019. In general, many investors believe the number of conflicting factors supporting continued performance of risk assets is generally offset by the number of factors supporting a retreat in valuations in the coming years. From our perspective, the pressure for retreat generally across risk assets appears to outweigh the pressure for appreciation in the short to intermediate terms.

Virtus General View on Real Estate

It remains our opinion that the easy money has been made in real estate in past years. Although commercial real estate will likely outperform other risk asset classes in 2019 and beyond, we should expect to see a broader dispersion of performance. In other words, there will be more clear winners and losers going forward, rather than the broader real estate bull we've experienced since coming out of the GFC.

The question becomes who will be the winners in 2019 and the years to come? I'll start with some high-level thoughts:

- **Property type selection will be more important than ever.** In general, we believe property segments with tenancy demand drivers that are sustainable during periods of distress will win. This includes those driven by undeniable demographic trends or inuring societal needs, such as healthcare, education, workforce housing (housing affordable by the average U.S. renter) and government tenanted buildings, the recent shut-down notwithstanding.
- **Primary markets and sustainable growth markets win.** This doesn't necessarily mean only gateway markets like New York, San Francisco and Los Angeles with all-time high valuations. It can also include other large metros that have diverse economic drivers, lower cost of living and growing populations, such as Atlanta, Dallas/Ft. Worth, San Antonio and Denver. Even high growth secondary markets that have compelling features drawing people and companies to those markets can fare well, such as Nashville or Charleston. The other side of the coin would indicate that smaller tertiary markets or even larger markets with declining populations and no real hope for reversal will likely suffer to a greater degree.
- **High barrier sub-markets win.** One of the biggest risks to several property segments is new supply coming online that outstrips demand in a given sub-market. Nothwithstanding the recent deluge of new multi-family supply (and to a lesser extent new office supply) in Central Business District ("CBD") areas, infill real estate investments should outperform in the coming years. This could mean gateway markets perform well given density and the infill nature of much of the metro areas. It could also mean high-barrier sub-markets inside of high growth metros offer a particular advantage over their higher cost counterparts in gateway markets.
- **Low leverage or lower risk leverage provides insulation from expected volatility.** Where there are concerns about forward-looking tenant demand, oversupply of competing product, or valuation volatility (especially cap rate expansion), making sure your debt doesn't force you into a corner is important. Keeping leverage low or using long-term fixed rate debt that has little to no performance covenants, such as Agency debt, gives the owner more optionality and the ability to hold through challenging scenarios that may arise. High risk debt strategies, such as higher leverage or using transitional debt (short-term, floating rate usually with constricting performance covenants primarily for assets in transition) for acquisitions will create challenges for owners and possibly the opportunity for patient investors to acquire distressed properties with high-risk capital stacks in 2020 and beyond.
- **Debt strategies are likely to outperform equity in the short-term.** Being lower in the capital structure by investing in senior loans, junior or mezzanine loans, or combined structures such as

unitranche loans, can serve an investor well if they're in a "risk-off" mindset. Debt investments not only lower your basis through coupon payments, but their last dollar is invested lower in the capital stack, thus they are a hedge against falling valuations. The problem is there are so many others with the same idea. Lenders, especially higher octane or transitional lenders like the plethora of debt funds that have been raised over the last few years, are awash with dry powder. Reportedly only 25% of debt fund capital raised has been deployed, suggesting at least $40 billion in unplaced private debt whose terms are becoming more speculative. To put capital to work, in many cases they're having to (1) accept lower coupons and total returns; (2) offer non-recourse and "covenant-light" terms; and/or (3) invest so high in the capital stack that they're taking on equity like risks, but without the upside afforded by equity investments. Accordingly, even if debt outperforms equity for the first time in many years in 2019, there are concerns that when there is a correction, lenders may not enjoy the same downside protection they have historically.

Virtus View on Individual Property Segments

With that as the backdrop, we'd like to share our views on different property types for 2019. Real estate performance is generally measured in terms of current yield and capital appreciation that can be further broken down into numerous categories of assessment. **However, we generally feel that it all ultimately comes down to the assessment of three different categories of variables that must be understood to have an informed view on each property type or individual property being considered for investment: (1) current and projected demand from tenants; (2) current and projected new supply coming online; and (3) current valuations relative to past and projected valuations.** One can also argue that capital flows in and of themselves are key to a sector's performance, and in many cases capital flows may not necessarily be tied to fundamentals as often they are driven by investor sentiment. We try to take all these factors and others into consideration when providing our views. Regardless, it's important to recognize that these views are for 2019, and real estate is a long-term investment, so making a decision to go long one property segment over another requires a multi-year outlook. We believe some property types may perform well in 2019, but there are greater headwinds for positive performance in the intermediate term, 2020 to 2022. It is also likely that we'll have a temporary compression of yields as cost of borrowing is likely to increase in 2019, yet we're still in the early stages of what will likely be cap rate expansion in a number of property segments.

Traditional Property Types, aka "Basic Food Group" of Investment Properties

Historically, institutional investors have owned approximately 90% of their portfolio holdings in traditional property types. Although these property types are often the most liquid categories of real estate, they also tend to be the most sensitive to economic, capital market and sociopolitical disruptions. They have done well since the GFC for several reasons, not the least of which is all the liquidity that has been pumped into the monetary supply and correspondingly falling interest rates. **It is our belief that Basic Food Group properties have greater headwinds for the coming years**, **given they are more beta sensitive, valuations are overly frothy and long-term demand fundamentals are neutral at best.**

As follows is our rating for each property segment, categorized as Red (negative), Yellow (caution/neutral) or Green (positive). We have likewise provided an assessment of our view on current and projected valuations, tenant demand and new supply. The overall call on the space may not directly translate from the individual calls on valuations, demand and supply, because one call may have higher intensity or importance than another call. Valuations assessments are made based on a combination of historical norms, future expectations and relative value compared to other property segment valuations today. It is important to recognize that these overall assessments are for the industry as a whole. There are numerous sub-sectors, markets or investment plays for each segment where we might have a more positive view than the industry overall.

- **Multi-family: YELLOW**

  Valuations: RED // Demand: GREEN // Supply: RED

  Multi-family has been in a struggle with its own success story for years now, as valuations and supply growth have seemed intent on smoothing out the sector's outperformance over other traditional property segments. Yet while 2018 saw pockets of concern in fundamentals (and valuations remain almost prohibitively high), the sector has retained its place as the most favored asset class with some of the strongest overall performance. Rent growth across the sector actually rose annually, from 2.4% to 3.6%, and occupancy remained stable at 94.0% nationally across the sector. That said, the parts of the multifamily sector traditionally most widely coveted by investors, Class "A" CBD apartments, have shown some of the weakest overall performance due to the concentrated supply growth in such sub-markets. Inventory growth in CBD areas has been over twice the relative rate of any other urban type, with some areas cresting into truly disruptive inventory growth dynamics. For instance, downtown San Diego, Miami, and Tampa have seen over 30% annual increases in Class A apartment inventory over the last year alone. High demand submarkets like Hollywood or Koreatown in Los Angeles have shown similar increases. The result has been softening occupancies and even negative rent growth in some submarkets while the apartment sector as a whole continues posting positive performance. This is largely due to structural and demographic drivers keeping households in the renter cohort with constrained housing options, a trend we will discuss in Workforce Housing.

- **Office: YELLOW**

  Valuations: YELLOW // Demand: RED // Supply: GREEN

  Investors in high quality office had reason for cheer in 2018: development and absorption of Class "A" product was fairly robust, buoyed by an expansive tech sector (indeed CBRE notes that 30% of the largest leasing transactions in 2018 went to STEM/tech tenants). That said, performance in less high-profile Office product was not as strong, with vacancy over 14% for Suburban Office, compared to roughly 10% for Core Urban product nationally. Our 2018 Outlook posited that the whole office sector is beset by obsolete product that has lingered despite new trends in hiring and space utilization, as most employers have become defensive in their human resources strategies since the GFC. Investors are following suit in this defensive outlook, with recent acquisition trends continuing to favor Class "A" assets in "Trophy" locations. It is also worth remarking that flexible, open seating arrangements and coworking are growing trends, both of which seek to use space potential in a more efficient way. Additionally, it's worth noting that a decade of recovery has not translated to a commensurate boom in office demand, so investors prudently bracing for lower economic health ahead should expect increasingly tepid performance, especially if the tech sector experiences a downturn.

- **Retail: RED**

  Valuations: YELLOW // Demand: RED // Supply: RED

  The retail landscape maintained the barbell performance we outlined last year, with destination, "experience"-oriented retail thriving and a landscape of store closures outside flagship malls—with Sears, one of the oldest national retailers in America, being the most recent casualty with plans to shudder 188 stores. Despite a strong 6.1% annual growth in consumer sales, retail real estate rent growth was only 1.2%, a decline after spending most recovery years hovering around 3% annually. One silver lining in the sector is the relative lack of supply growth. Development

pipelines for strip malls and power centers have cratered, leaving malls the mainstay of the pipeline. Investor appetite has followed suit, with cap rates across all product types rising, except for high quality malls. The headwinds facing retail are uneven and slow, but they are likely ineluctable and will only intensify as time goes on. The USA still has roughly five times the amount of retail space per capita as the United Kingdom, and much of it is increasingly obsolete when competing with e-commerce options. As such, 2018 saw significant store closures not only in headline bankruptcy stories like Toys R' US, but also in heretofore perennial performers like Macy's, which closed many locations. The situation is perhaps even more intense than in office, where a small subsector of "blue chip" assets are heavily coveted, while cheaper product languishes. The euphoria and perceived resilience around "high-street" retail may also abate given closures of many retailers even in iconic Manhattan locations, such as Ralph Lauren, Gap and the like. This trend of closures should continue among similarly positioned commodity retailers that do not offer any experiential "draw," which will in turn impact pricing and fundamentals even for investors who have aligned themselves with more resilient tenants. In the coming years, those able to take advantage of purchasing retail assets at depressed prices and reposition toward atypical tenants from more resilient industries will likely perform well.

- **Industrial: YELLOW**

  Valuations: RED // Demand: GREEN // Supply: YELLOW

  Industrial has quickly become the most dynamic and discussed trend in commercial real estate, shifting remarkably from its state a few years ago as a niche sector. The misfortunes of retail have been the fortunes of industrial, and while industrial properties will undoubtedly benefit from an increasing degree of e-commerce, the current level of enthusiasm could overshoot the longer term needs in some areas due to the degree of development, the low barriers for exurban distribution space, and the fickleness of demand drivers. While occupancies are historically high, construction pipelines have risen to over 300 million square feet, the majority of which is not yet preleased, in contrast to prior years in which the vast majority of the pre-leased pipeline. CoStar notes that rent growth declined from above 7% in 2017 to 6.1% in 2018, both of which are remarkably strong, but with projections of a continued decline due to economic uncertainty, trade wars and new supply. Indeed, the strings pulling industrial fundamentals are a complex web of global trade. For instance, CBRE notes that industrial import needs require three times as much space as exports, and in the event of a simultaneous economic downturn and protectionist trade regime, raw demand for distribution space would quickly implode. Nonetheless, while the current industrial sector is seeing booming rent growth and historically tight occupancies, it is likely that investment demand and development will continue until checked. Finally, investors doubled down on last year's record transaction volume with another year of historic purchases. As in 2017, the market was dominated by large portfolios, with portfolios as a percent of total volume rising from roughly 37% to 46% last year. There was also substantial entity level consolidation, with Prologis acquiring REIT competitor DCT, meanwhile Blackstone acquired Pure Industrial Real Estate Trust for $3.8 billion. While cap rate spreads are higher than in 2007, the cap rates for these kinds of prime portfolio transactions declined to a historical sector low of 4.2%, presenting risks in an environment of rising interest rates and unclear economic outlook.

- **Hospitality: RED**

  Valuations: YELLOW // Demand: YELLOW // Supply: RED

  Looking back on last year's Outlook, we find ourselves satisfied at the quality of predictions given the volatile and unclear nature of this moment in both the economic and real estate cycles. That

said, the hospitality sector had a strong year in both performance and investment appetite despite being categorized as "red" for caution last year. Nonetheless, we retain our negative outlook on the sector, chiefly as it constitutes the most beta-sensitive sector, with both leisure and business travel grinding to a halt during economic downturns, in part because it rebalances so quickly compared to retail or industrial. In addition, inventory growth rose to nearly 2.5% annually (cresting above all other major types toward the end of 2018), with rate growth slowing and signs of a downward inflection point in occupancy. We believe most hotel assets are not priced with the possibility of a downturn occurring within a typical short hold period, especially given the robust 2018 valuations hotel assets maintained. In addition, 2018 saw a shift toward Tier 2 markets last year, in contrast to more defensive attitudes in 2017. Again, Virtus cautions hospitality investors to be mindful of this sector's tendency to be more volatile than even retail or office, and to ensure their business plans have significant time flexibility and margins of safety to withstand declines in Revenue per Available Room, as well as to withstand sector challenges like HomeAway and AirBnB.

Alternative Property Types, aka "Recession Resilient" Investment Properties

Alternative or niche property types generally connote segments outside the Basic Food Group of commercial real estate properties. Some investors have deemed these "recession resilient" or "cycle resilient" categories due to the greater sustainability of tenant demand as compared to Basic Food Group segments. However, the word is out, and many new investors have been flocking into these categories over the last several years, driving up valuations to all-time highs while also creating greater liquidity for the long-term as these assets have become more institutionally accepted. Simultaneously, there have been quick entrances and exits from several new large players in these categories who did not fully appreciate the idiosyncratic risks and operational intensity of these categories. As such, there has been a wider dispersion in performance across these sectors, despite the general outperformance relative to the Basic Food Group. **In summary, we believe these categories generally offer a more compelling risk-adjusted return than the Basic Food Group, especially in this part of the cycle, but that presupposes the investor is a specialist in these categories who is well-versed in sidestepping the real estate and operational landmines unique to each of these property segments.**

Below are our ratings of only the major sectors of the alternative property categories. This is not meant to be an exhaustive list, as there are a number of other so-called niche property categories in addition to these.

- **Medical Office: GREEN**

  Valuations: YELLOW // Demand: GREEN // Supply: GREEN

  The Medical Office ("MOB") sector is currently highly in favor with investors, and while 2018 saw a small decline compared to 2017's historic rates of acquisition, pricing remains the chief challenge in this otherwise healthy sector. Occupancies have remained locked within a 300 bps spread through the GFC and currently sit at 92.0%, just a few basis points below last year. Rent growth has remained consistently strong, and Revista notes that unlike in other healthcare subsectors, MOB expenses have not grown more rapidly than revenue, leaving Net Operating Income healthy. All of this derives from a few consistent demand drivers that persist despite the volatility of American healthcare regulations in political discourse. The "greying of America," current and projected increases in healthcare expenditures, and evolution in healthcare have led to the increased need for healthcare real estate and investor appetite with it. Part of this increase in investor demand has led to higher valuations and liquidity, because investors recognize that medical office offers lower risk relative to other real estate investments available today. High operating margins, long leases, and good credit (healthcare is needs based and doctors and other healthcare service providers in general have lower default rates than other tenants) provide for

stable future cash flow. Barriers are generally higher in this category, which has led to limited new supply of only 1.5% p.a. average inventory growth over the last five years despite significant tenant demand and replacement of functionally obsolete properties. In short, Medical Office requires a much greater degree of regulatory and healthcare sector knowledge compared to traditional office, but for investors who take the time to make informed decisions regarding individual investment and tenants, it presents a ripe opportunity in the current environment.

- **Student Housing: YELLOW**

  Valuations: RED // Demand: GREEN // Supply: YELLOW

  As we expected in our 2018 Outlook, student housing had a challenging year for a number of investors, because valuations remained at all-time highs while certain university markets have had tepid performance due to inventory growth and overzealous expectations. As a whole, the sector leased up only slightly behind the prior year, and the most dramatic oversupply dynamics remain confined to select low barrier college towns. But the forward pipeline remains considerable, while over 40,000 units have been delivered for multiple years now. Although the sector has demonstrated admirable non-correlation and strength during downturns, it is unclear whether there remains enough depth of market to satisfy short term interest.

  That said, our prediction that new investors, who didn't appreciate the operational intensity and idiosyncrasies of the sector, would ultimately exit also proved true; there were several notable joint ventures between established operators and new institutional investors that did not lead to fruitful partnerships due to overreach and missed expectations. In addition, the groundswell of foreign investment that buoyed 2017 investment volume was not as strong during 2018, yet total volume rose back to $10.9 billion, all dominated by private buyers. That said, Virtus still expects a cooling down for the sector that will make room for more prudent investors with a longer term affinity for the space. University enrollment and hence student housing demand will likely remain strong at the Tier 1 public universities, but lower quality schools will have headwinds as students and parents are demanding a better Return on Investment for their elevated and rising educational expenditures. Demand as measured by penetration rates of those attending post-secondary education institutions has decreased slightly in recent years, but is stable and remains extremely high across the U.S. Frothy valuations and new supply continue to be the central risks. An experienced student housing investor may be well-served to acquire temporarily distressed assets in the coming school years as a result of overzealous building at high-quality universities with sustainable enrollment growth.

Senior Living: GREEN

Valuations: YELLOW // Demand: GREEN // Supply: YELLOW

Senior Living is another asset class that benefits from long term demand tailwinds. Unlike Medical Office, Senior Living assets have a longer runway before they fully benefit from the aging population, and the current environment has seen historical levels of inventory growth in certain low-barrier markets. Much like student housing, this trend has been accompanied by a groundswell of investor demand, including many new investors from the U.S. and abroad. The result has been an investment landscape with widening outcomes. Defensible, higher barrier markets have seen demand hold steady and robust rent increases, whereas weaker markets have seen occupancies drop to historic lows. Yet even in low barrier markets, absorption has been historically high due to the robust demand drivers for the sector. Fueled by an aging population, greater acceptance of the product type by "qualified seniors" and their families, and evolving baby

boomer preferences, senior living continues to produce attractive income streams and attract investor interest and capital flows, now globally. Not only has senior living outperformed even multi-family since the GFC, it continues to produce real estate industry leading returns during economic dislocations (particularly in private pay "needs-based" properties, such as assisted living and memory care). Although occupancy saw a drop in 2018 due to increased supply, fundamentals are strong with increased revenues and improving operating margins generally across the industry. Caution is noted in certain low barrier markets that are less insulated from new supply and smaller markets that are more vulnerable to labor costs and operating margin pressures, leading to more of a negative or cautious view on Senior Living. Class A assets in higher barrier markets will continue to be the asset of choice for 2019 as institutions and foreign buyers look for increased exposure to this growing segment. Medium to long-term would definitely be a green assessment for the space, but investors should expect short-term challenges in 2019 due to new supply risks in low barrier markets and sub-markets. For more on concerns for new supply risk in senior living, see our 2018 paper on the subject.

- **Data Centers: YELLOW**

  Valuations: RED // Demand: GREEN // Supply: YELLOW

  Data Centers are not necessarily considered recession resilient, but they are often part of the alternative property type discussion, especially in recent years. Data Centers are one of the very few sectors with a "risk on" attitude from investors in the current climate and a major outlier in investment volume; 2017 volume exceeded the prior three years combined, and 2018 volume kept pace. Supply growth also continued to be robust and dispersed, with some markets like Northern Virginia seeing a nearly 25% annual increase in new capacity (as of mid-year, well before the Amazon HQ2 announcement) and many others likewise in double digit territories. However, whereas 2017 was dominated by smaller enterprise users (as large hyperscale cloud users were busy stabilizing their active 2016 activity), cloud users returned to the market in full force for 2018, with 177 megawatts of net aborption in the first half of the year alone. Hyperscale cloud users tend to pursue preleased development, but with less robust rent premiums. Vacancies continue to be tight but have increased greatly in certain markets like Phoenix and Chicago. Although demand continues to look robust, there remains concern about the long-term fundamentals of the space due to the tenant profiles and often quoted headwind of constant innovation and functional obsolescence of the hardware occupying the space.

- **Self-Storage: YELLOW**

  Valuations: RED // Demand: GREEN // Supply: YELLOW

  Self-Storage is another sector that has recently suffered from its own success. Occupancies have begun to dip after two years of truly historic development levels. Nonetheless, the industry's success from years past has led to heightened investment momentum, and this has led to extreme valuations in recent years, aggressive NOI growth assumptions from investors, and more recently, early signs of an overabundance of new supply. While REIT properties, which tend to be higher quality stabilized product, have continued to do well, same-store REIT NOI growth dipped to 2.2% after having posted double digit figures in the peak year of 2015. Notably, REITs continue to be net buyers despite having cooled their own development pipelines in response to private developers. While the industry has witnessed consolidation, it is still highly fragmented, so there are opportunities in select markets and investment strategies to yield good results. Although the long-term view is positive, the industry as a whole will be challenged in the short-term given

current entrance pricing for acquisitions and heightened new supply risk, especially in low barrier to entry markets.

- **Workforce Housing: GREEN**
  Valuations: RED // Demand: GREEN // Supply: GREEN

  The recent dislocation in rents and occupancies between Class A multifamily (which has faltered a bit) and the less visible older Garden Style product has led investors to recognize a new asset class. Indeed, when Virtus began investing in Workforce Housing years ago, it required regular definitions to some skeptical investors and operators, whereas the term has become quite common as of 2019. Though "workforce housing" has numerous connotations, we view the space as quality affordable housing for the mass renters market. We believe this is one of the most compelling areas for investment, given the need for a more affordable option to house the vast majority of Americans, especially when the next economic downturn occurs. There are numerous ways to execute in workforce housing, such as class B/C multi-family properties that are far more affordable than Class "A," and offer greater resiliency during economic downturns, yet higher rental rate growth potential. Other strategies include larger scale single family rentals ("SFR"), manufactured housing, micro-apartments (and other high density housing) or other residential properties using disruptive lower cost building techniques.

  The common thread has been the recent outperformance of these assets compared to the more traditional landscape of marquee new apartments. Workforce housing assets have continued to post strong rent growth at 4.0%, with occupancy sitting at 94.9%, over 300 basis points above Class "A." In addition, historical performance during the GFC also favored Workforce Housing, with rents declining only 3.3% in 2009, compared to 4.7% in Class A. In short, construction costs and decades of development-averse urban zoning policy have made development of workforce housing product commercially unfeasible. The result has been a protracted housing shortage combined with economic forces keeping many households out of homeownership. Since new development is generally not commercially viable, private investors willing to take on value-add renovations of fundamentally sound buildings are able to breathe new life into existing assets and offer median income renter households a more attractive home among scant options. The long-term fundamentals are most compelling, but a prudent investor can never lose sight of cost basis, especially now, where increasing numbers of investors have driven valuations to historic levels. In addition, consumers have not experienced wage gains to match the rapid rent growth across the sector with only recent modest wage growth in 2018. Rents can only grow so far before they either become overly restrictive or else policies like rent control (which is again being discussed in California) become resurgent. Chiefly though, the problem is simply one of valuations. Nonetheless, Virtus believes a prudent investor can find numerous attractive options in the current environment if they do their homework and maintain the discipline to pass on assets that are not priced to weather a more tepid period of rent growth brought on by an economic downturn.

In conclusion, capital market volatility, frothy valuations and concerns over sustainability of demand for more economimcally sensitive property segments have many investors concerned for 2019 and beyond. Having said that, commercial real estate still likely wins the "relative beauty contest" compared to most other categories of risk assets. Within commercial real estate, an investor will likely be well-served to be cautious with the construction of their deal-level capital structure and to focus on areas with sustainable demand drivers, whether that's targeting the more resilient property segments and/or certain markets and sub-markets that offer better supply and demand fundamentals.

Traditional Property	Overall	Valuations	Demand	Supply
Multifamily				
Office				
Retail				
Industrial				
Hospitality				

Alternative Property	Overall	Valuations	Demand	Supply
Medical Office				
Student Housing				
Senior Living				
Data Centers				
Self Storage				
Workforce Housing				

To review the predictions provided at the beginning of 2018, the Virtus 2018 Real Estate Market Outlook piece is available here.

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