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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

3 Real Estate Trends To Watch In 2018

By **Andrew McIntyre**

Law360, Minneapolis (January 1, 2018, 3:04 PM EST) -- Just how brick-and-mortar retail will evolve amid continued pressure from Amazon.com Inc. and e-commerce writ large is one of several trends real estate lawyers will have their eyes on in 2018.

Besides trying to get a sense of the future of retail, lawyers are also closely monitoring the interest rate and financing landscape, another big question mark for 2018. Less speculative is the current trend of vast amounts of foreign capital flowing into U.S. real estate, which is expected to remain largely in place in 2018.

Here, Law360 looks at three areas of real estate lawyers will be closely watching in the coming year.

Evolution of Retail

Amazon's blockbuster purchase of Whole Foods in 2017 rocked the retail and grocery world, and has created much uncertainty for the grocery-anchored mall model, adding to what was already a challenging environment for brick-and-mortar retail, lawyers say.

"When Amazon bought Whole Foods, I think people got a little spooked," said David Forti of Dechert LLP. "Next year will an interesting year to see how the market treats anything with a retail component, even grocery-anchored retail, which is traditionally viewed as safe."

Owners of retail properties are reacting in various ways. While some are keeping their properties as retail and adding restaurants and other entertainment, lawyers expect in 2018 to also see more conversion to other uses.

"Replacing retail with retail, office and residential ... it's a really big trending topic," said David Phelps of Akin Gump Strauss Hauer & Feld LLP.

Andrew Raines of Raines Feldman LLP said many retail-focused real estate investment trusts will either have to "scale up and consolidate" or "start spinning off" as they, too, face the question of how to deal with excess retail space at malls.

And amid e-commerce pressure not only in the grocery space but across all of retail, lawyers expect big-box retailers to also increasingly move toward the Amazon model by combining brick-and-mortar sales with e-commerce and distribution.

"Retailers like Walmart are talking about getting into the home delivery service. It is changing the dynamic quite a bit," said Michael Phalen of Lewis Roca Rothgerber Christie LLP. "Retail's kind of suffering ... [and] industrial's the new retail."

Less Financing Activity

Interest rates remained close to record lows in 2017, driving many firms to spend more energy on refinance and less time on mergers and acquisitions, but lawyers expect that to change in 2018.

"For fixed-rate refinance, volume is not going to be there" in 2018, Forti said. "Property sales and M&A activity are going to be more important to driving the market in 2018, as opposed to refinancing."

One reason for the anticipated slowdown in financing next year is that many of the 10-year loans made at the height of the last real estate boom have now been refinanced. "There are not as many loans coming due," Forti said.

But interest rates may also drive decisions in 2018, with anticipated rate increases coming from the Federal Reserve.

And there is also uncertainty over how the end of quantitative easing, which started when the U.S. government bought massive amounts of bonds during the Great Recession, will play out.

"We've never had QE. We didn't know what it would do, and we don't know what the undoing of it will do," Raines said.

"There are general interest rate issues that will come up," he added. "You're probably going to start seeing some alternative capital being used in real estate ... to fill in the gap where underwriting may be difficult for real estate investors."

Continued Influx of Foreign Capital

Foreign investment in U.S. real estate has been a major story the past several years, and lawyers see that continuing in 2018 as U.S. commercial real estate still remains an attractive place for foreign firms to park their capital.

"I think that this trend is going to continue in 2018. I think it's going to be even bigger," said Michael Haworth of Orrick Herrington & Sutcliffe LLP.

"You're going to see much more breadth and depth of types of investments these companies are going to pursue," Haworth said. "Different markets. Secondary and tertiary markets. Different asset classes."

While foreign investors have poured capital into trophy office properties in gateway cities like New York, Los Angeles and San Francisco, lawyers expect investors in 2018 to pay more attention to smaller U.S. cities as prices in major markets remain high.

"In 2018, I expect to see more of the same. International players looking for stable markets, willing to accept a lower return to be in the right cities," said Tim Watkins of Goulston & Storrs PC. "While leasing is slowing in the office market, I don't think that will necessarily turn the foreign buyers off."

And lawyers expect foreign pension funds, which often move more slowly than other real estate investors, to ramp up their purchases of U.S. real estate in 2018.

"A lot of what's going to drive future investment in the U.S. real estate market is activities in the major pension funds. Once that segment of the market has jumped in with both feet in the U.S., you’re going to see even more activity," Haworth said.

"We meet with groups all the time," he said. "It probably takes these companies really a year or two to understand the market before they jump in."

--Editing by Brian Baresch and Katherine Rautenberg.