Imperion Insights - September 2017

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It has been an interesting year to say the least in the apartment industry. On one hand, one can argue there are quite a few significant changes at work, while at the same time -as deal flow screeches to a halt - one can make a strong point there just isn't much going on.

New market dynamic

If you are in this business long-term you would be remiss not to pay attention to whats happening to the 10-year treasury rates. At the time of my last newsletter (circa November 2016) the 10-year treasury was trading at 1.8%. Approximately 10 months and one new US President later, we find ourselves sitting elegantly at 2.3%.

Ladies and gentlemen, make no mistake about it, this is an astounding move in

Where is the yield?

Over the last 10 months, I have underwritten somewhere between 20-30 deals - many of which were "off-market" deals - and my over-arching conclusion is that for the most part, the yield (in Houston) is gone. It is fair to say there is consensus around the thought that deep value-add deals have been scarce in the market for quite a few years now as distressed assets have all been gobbled up. But now it has become apparent that the search for yield has become almost just as challenging.

Those of you who know my investment profile, know that I prefer to focus on yield first, with the value-add component being the proverbial "cherry on top". With both of those components being apparently non-existent, what is an investor to do?

I have summarized a few thoughts that I think are particularly important in this environment.

1) This is a tough market - be particularly cautions of overly aggressive underwriting. It is easy to make returns look rosy on paper.

2)More than ever, look for experience and rates with consequential impacts to the marketplace. By the way, all other variables held equal this is not a move that is particularly kind to real estate values, as CAP rates tend to be positively correlated to interest rates, and the 10-yr treasury bond being the benchmark many lenders use as a basis for their lending rates.

While it is yet to be determined how this will play out, one thing is very clear and noticeable - deal flow has slowed down dramatically. My sense (and hope) is that sellers are "getting wind" of the new world order, but I have been wrong once or twice before.

It is also quite significant when Jim Hurd, one of the biggest brokers in town, comes out with a "State of the Market" address and says among other things that the "B" and "C" segments of the market are seeing softness and he is cautious on the Houston market short-term. What?? Brokers are never cautious... and I happen to agree with him.

On another completely different but equally relevant note, according to LMI Capital, there is approximately $90B in debt coming due this year nationwide, and roughly 30% of it is non-refinanceable debt in some degree of distress. These were, for the most part, deals done at the peak of the market in 2007, right before the mud hit the fan. I am a huge fan of the folks at LMI Capital, but this assertion does puzzle me a bit.

And yet, it sure feels like there is not much going on...

track record.

3) Make sure you understand the deals you are considering, what is the projected total investment returns to the limited partners (e.g. passive investors), what is the exit strategy.

4) Be open to other markets with more favorable returns.

5) Remember that liquidity; while it is a good thing, it is arguably expensive as the opportunity cost of having our money parked in the bank is high.

Additionally, I would like to share with you what I consider to be the main pillars I look for when considering a new acquisition.

- Proven sub-market (i.e. high rental demand by a qualified tenant base)
- Evidence of opportunities to create value by improving operations
- Good drive-by visibility
- Good infrastructure (manageable amount of deferred maintenance)
- Potential long-term hold

While there is no guarantees in business and no such thing as a risk-free investment, I believe a combination of some or all of these pillars should yield solid returns on our invested capital, and increase our ability to get through tough times.

Until next time!

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