REALASSETS ADVISER

Looking at the Future of the Securitized 1031 Exchange Industry

Fresh off another record-breaking year, Inland Private Capital Corporation (IPC) remains the industry leader in securitized 1031 exchange transactions. As a part of The Inland Real Estate Group of Companies, Inc. (Inland), IPC provides private placement real estate investment solutions to accredited investors as an alternative to traditional stocks and bonds. Many of its offerings are designed to qualify as replacement property for an IRS Section 1031 exchange through multiple-owner investment structure. Inland is one of the nation's largest commercial real estate and finance groups, and recently celebrated 50 years in the real estate industry.

We sat down with IPC's President, Director and Chief Operating Officer, Keith Lampi, to discuss what's in store for the 1031 exchange industry in 2019.

As we enter 2019, what do you think is in store for the securitized 1031 industry?

Next year, I see continued growth in investor demand and additional expansion in product diversity. Strength in asset pricing coupled with the product's strategic play on demography will have a key role in sustainable growth in investor demand. The aging baby boomer cohort of investors has demonstrated an increasing desire to sell highly appreciated properties that have been actively managed and exchange proceeds into a passive ownership vehicle, which is a financial-planning phenomenon that should drive investor appetite for securitized 1031 product many years to come.

Expansion in product diversity has been a long time coming, as investors have been left hungry for more options in recent years. In 2018 alone, the securitized market was weighted heavily in the apartment sector, with more than 60 percent of the offerings brought to market falling into the multifamily category. At this point in the market cycle, I believe apartments are a great long-term buy, and the operating asset characteristics fit the mold very well for securitized 1031 product structure. That said, broader diversity that provides investors access to a wider spectrum of options is a healthy aspirational goal for our industry and is a goal I believe is attainable in 2019.

LEADERSHIP

Keith Lampi
President, Director and Chief Operating Officer

What do you foresee being the biggest trend in 2019 for the securitized 1031 industry?

One of the headline trends I foresee is the potential for yield compression as it relates to new products brought to market. It is impossible to ignore the myriad of macroeconomic trends that have already begun to reset return expectations in our marketplace, as well as the general investing market as a whole. Interest rates have been trending upward for the past 12 months, with little to no adjustment in asset pricing. While one might make the argument that asset pricing on a capitalization rate basis historically tracks with interest rates (meaning as rates rise, prices drop), we simply are not seeing that occur. Much of this is driven by the fact that investment capital continues to aggressively pursue a healthy allocation to real estate. Foreign capital, private equity and institutional capital have all increased their participation and allocations in commercial real estate, which has kept valuations strong. This is a positive sign for the real estate market as a whole but will have an inevitable effect on cash flow and rates of return that investors should expect to receive.

In my opinion, this year will be an inflection point for our industry, leaving product sponsors with one of two options: (i) continue to structure programs that generate cash-on-cash returns that track with prior years by purchasing lesser-quality assets or incorporating more aggressive underwriting assumptions into financial projections, or (ii) factor the current macroeconomic climate into new product offerings, and work toward educating investors and resetting expectations with respect to cash-on-cash return projections.

What asset sectors are expected to be hot in 2019?

At this point in the market cycle, we are bullish on asset types with attributes that have a lower correlation to near- and mid-term economic growth. I often refer to these asset types as life-driven businesses, meaning irrespective of where we are in an economic cycle, the consumer's innate need for our product will drive performance. Asset types that fall into this category include, but are not limited to, residential, healthcare and self-storage property types.

What markets are expected to be hot in 2019?

Markets that have long-term population and employment growth, as well as a strong prospect for continued economic viability, comprise our target market list. Markets that exemplify these characteristics include, but are not limited to: Denver, Orlando, Tampa, Jacksonville, Charlotte, Raleigh/Durham, Las Vegas, Atlanta, Minneapolis, Phoenix and Salt Lake City, to name a few.

What are the best opportunities to generate income in the current rising rate environment?

Opportunities best positioned to generate income, while also striking a balance toward preservation of capital in this current economic environment, are assets that have inflationary protected characteristics. In many instances, these are operating assets that provide more frequent opportunities to increase rents through shorter-term leases and allow the sponsor to manage the expense side of the NOI equation. From an investment management perspective, scale can also play a key role in providing investors the benefit of acquiring properties in markets where a management footprint currently exists. This approach can create efficiencies, which can help in reducing expenses and increasing the NOI and overall performance of the property.

How has the process of evaluating an asset and structuring a deal changed over the years?

The IPC management team prides itself on being nimble and dynamic in our ability to respond to the ever-changing market trends. As a result, our company's asset selection process has evolved dramatically over the years in response to macroeconomic conditions and market demand. For example, during IPC's early years, our platform focused predominantly on long-term net-lease assets in the retail and office sectors. Today, given where we are in the economic cycle, we have shifted our focus to assets in the multifamily, self-storage and healthcare sectors.

In addition, the structure of our products has been fluid, to say the least, with the most notable change tied to the products' fee structure. Over the past several years, we have focused on reducing the up-front cost structure associated with product offerings, which can have a beneficial impact on the back-end performance.

How does IPC stay competitive and attract investors within the growing 1031 market?

IPC focuses on creating innovative product offerings, which has driven our growth in assets under management, with an equal dedication to enhancing our resources allocated to operations, investor reporting, technology, customer service and asset management. We plan to attract investors by providing a menu of differentiated product offerings, in the form of different leverage points, financing structures and asset classes — helping to provide investors access to a variety of investment strategies and asset types. Having our finger on the pulse of the market positions us well, allowing us to uncover opportunities that meet our specific criteria in a hyper-competitive environment. The key that ties all of this together is maintaining a long-term-minded, disciplined approach when evaluating opportunities in the marketplace. This approach has driven our success through various market cycles over the years.

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