September 22, 2016

Economics Group

Anika R. Khan, Senior Economist
anika.khan@wellsfargo.com • (212) 214-8543

Will the Potential EB-5 Expiration Ease CRE Valuations?

U.S. financial regulators have brought attention to the significant rise in CRE valuations, which is gaining some fuel from foreign investors. We explore whether the expiration of the EB-5 program could ease pricing.

EB-5 Expiration Looms

Faced with a downturn in economic activity, the EB-5 Program was created by the U.S. Congress in 1990 to stimulate economic activity through job creation and capital investment with help from foreign investors. Two years later, Congress created the Immigrant Investor Program, also referred to as the Regional Center Program, which sets aside EB-5 visas for participants that invest in commercial enterprises approved by the U.S. Citizenship and Immigration Services. With the minimum qualifying investment of $1 million, or $500,000 in a high employment or rural areas, foreign investors may obtain permanent resident status.

Although foreign investors can invest on their own, most use a regional center to pool money together. In 2007, there were nine regional centers and less than 800 investors. Today there are more than 860 regional centers and almost 9,500 investors, with the peak at more than 10,690 in 2014 (top chart). In 1992, foreign direct investment (FDI) through the EB-5 program was $120 million, reaching a cycle peak of $555 million in 1997. The program has regained interest in recent years, with more than $13 billion invested since 2012 (middle chart). The program is set to expire on Sept. 30, which could slow overall cross-border transactions in CRE.

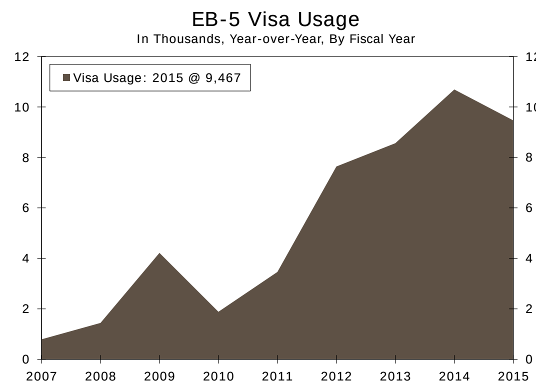
CRE Pricing and Cross-Border Transactions

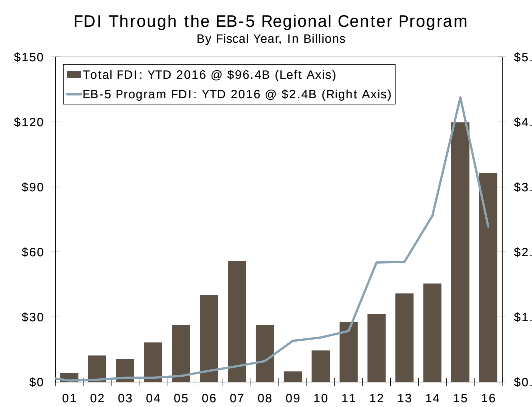
FDI has grown significantly in recent years, as foreign investors have reached for yield in a global low-interest rate environment, putting some upward pressure on CRE valuations. We have written on this topic in previous reports and find the spike in pricing is not broad based and is largely concentrated in major markets in the apartment and office central business district sectors (bottom chart). Some financial regulators have raised concern about potential imbalances in the CRE market, with Boston Federal Reserve President Eric Rosengren being the most outspoken.

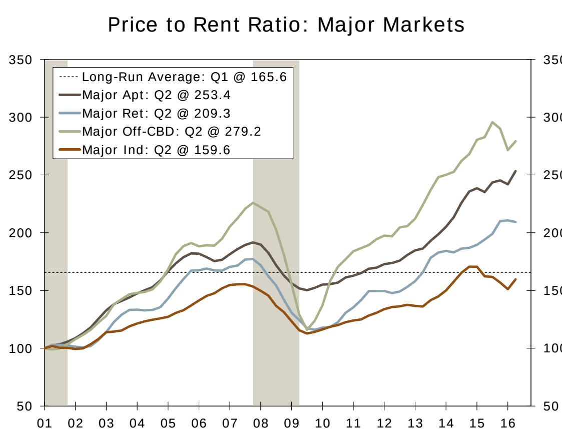
In a late-August speech, he mapped out potential risks of an overheating CRE market stating, “should prevailing economic conditions change in response to large negative economic shock, CRE prices could decline relatively quickly, leading to large losses at leveraged firms.”

Given the impending expiration, we expect some pullback in CRE FDI, which should further ease some of the upward pressure on CRE valuations, especially in markets preferred by foreign investors. However, using Real Capital Analytics data, the program only accounts for about 5 percent of overall cross-border transactions.

We suspect most of the ease in valuations would be in major markets in the apartment and office central business district (CBD). Moreover, lenders have taken notice of these pockets of risks and have tightened lending standards, especially for apartment and construction loans.







Source: IIUSA.org, RCA, Inc., CoStar Realty Information, Inc. and Wells Fargo Securities

Wells Fargo Securities Economics Group

Diane Schumaker-Krieg	Global Head of Research, Economics & Strategy	(704) 410-1801 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 410-3275	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Jay H. Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Currency Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Anika R. Khan	Senior Economist	(212) 214-8543	anika.khan@wellsfargo.com
Eugenio J. Alemán, Ph.D.	Senior Economist	(704) 410-3273	eugenio.j.aleman@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 410-3270	azhar.iqbal@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Eric Viloria, CFA	Currency Strategist	(212) 214-5637	eric.viloria@wellsfargo.com
Sarah House	Economist	(704) 410-3282	sarah.house@wellsfargo.com
Michael A. Brown	Economist	(704) 410-3278	michael.a.brown@wellsfargo.com
Jamie Feik	Economist	(704) 410-3291	jamie.feik@wellsfargo.com
Erik Nelson	Currency Analyst	(212) 214-5652	erik.f.nelson@wellsfargo.com
Misa Batcheller	Economic Analyst	(704) 410-3060	misa.n.batcheller@wellsfargo.com
Michael Pugliese	Economic Analyst	(704) 410-3156	michael.d.pugliese@wellsfargo.com
Julianne Causey	Economic Analyst	(704) 410-3281	julianne.causey@wellsfargo.com
E. Harry Pershing	Economic Analyst	(704) 410-3034	edward.h.pershing@wellsfargo.com
May Tysinger	Economic Analyst	(704) 410-3059	may.tysinger@wellsfargo.com
Donna LaFleur	Executive Assistant	(704) 410-3279	donna.lafleur@wellsfargo.com
Dawne Howes	Administrative Assistant	(704) 410-3272	dawne.howes@wellsfargo.com

Wells Fargo Securities Economics Group publications are produced by Wells Fargo Securities, LLC, a U.S. broker-dealer registered with the U.S. Securities and Exchange Commission, the Financial Industry Regulatory Authority, and the Securities Investor Protection Corp. Wells Fargo Securities, LLC, distributes these publications directly and through subsidiaries including, but not limited to, Wells Fargo & Company, Wells Fargo Bank N.A., Wells Fargo Advisors, LLC, Wells Fargo Securities International Limited, Wells Fargo Securities Asia Limited and Wells Fargo Securities (Japan) Co. Limited. Wells Fargo Securities, LLC. is registered with the Commodities Futures Trading Commission as a futures commission merchant and is a member in good standing of the National Futures Association. Wells Fargo Bank, N.A. is registered with the Commodities Futures Trading Commission as a swap dealer and is a member in good standing of the National Futures Association. Wells Fargo Securities, LLC. and Wells Fargo Bank, N.A. are generally engaged in the trading of futures and derivative products, any of which may be discussed within this publication. Wells Fargo Securities, LLC does not compensate its research analysts based on specific investment banking transactions. Wells Fargo Securities, LLC's research analysts receive compensation that is based upon and impacted by the overall profitability and revenue of the firm which includes, but is not limited to investment banking revenue. The information and opinions herein are for general information use only. Wells Fargo Securities, LLC does not guarantee their accuracy or completeness, nor does Wells Fargo Securities, LLC assume any liability for any loss that may result from the reliance by any person upon any such information or opinions. Such information and opinions are subject to change without notice, are for general information only and are not intended as an offer or solicitation with respect to the purchase or sales of any security or as personalized investment advice. Wells Fargo Securities, LLC is a separate legal entity and distinct from affiliated banks and is a wholly owned subsidiary of Wells Fargo & Company © 2016 Wells Fargo Securities, LLC.

Important Information for Non-U.S. Recipients

For recipients in the EEA, this report is distributed by Wells Fargo Securities International Limited ("WFSIL"). WFSIL is a U.K. incorporated investment firm authorized and regulated by the Financial Conduct Authority. The content of this report has been approved by WFSIL a regulated person under the Act. For purposes of the U.K. Financial Conduct Authority's rules, this report constitutes impartial investment research. WFSIL does not deal with retail clients as defined in the Markets in Financial Instruments Directive 2007. The FCA rules made under the Financial Services and Markets Act 2000 for the protection of retail clients will therefore not apply, nor will the Financial Services Compensation Scheme be available. This report is not intended for, and should not be relied upon by, retail clients. This document and any other materials accompanying this document (collectively, the "Materials") are provided for general informational purposes only.

SECURITIES: NOT FDIC-INSURED/NOT BANK-GUARANTEED/MAY LOSE VALUE

WELLS FARGO SECURITIES