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## 2010 Spells Pain, Except for Smart Investors

The general sentiment across the industry is that 2010 will bring even more pain to the market before showing signs of improvement. According to more than 900 commercial real estate professionals polled by the Urban Land Institute and PricewaterhouseCoopers, the industry is expected to bottom out at some point next year, a year after the residential housing market collapsed. "Incredibly, this industry collapse is going to be worse than the early 1990s and the worse thing we've suffered since the Great Depression," with expected value declines of 40% to 50%, on average, from the peak hit in midyear 2007, stated Stephen Blank, ULI's senior resident fellow for real estate finance. Blank, along with PwC consultant Jonathan Miller, unveiled the findings of the joint study, "Emerging Trends in Real Estate 2010," at the ULI conference here yesterday. On the investment front, those polled believe the coming year will be the worst time for property sellers in the survey's 31-year history, but that's good news for buyers. Buying and sales activity may increase as borrowers and lenders feel increasingly pinched by the economic conditions. The "black hole" for many buyers, said Blank, will continue to be where financing will come from to get deals done. "Unquestionably, 2010 and 2011 are going to set the stage for a monumental timing play for investors who've got capital and want to buy properties at a cyclical low point," he added. Expect defaults and delinquencies to increase as workouts get under way in 2010, and as soon as reserves at financial institutions reach adequate levels, insurance companies and banks will finally be able to address their loan problems rather than playing the pretend-and-extend game. For property fundamentals, the state of the economy remains the number-one hurdle. Though all sectors are hurting, on a relative scale, apartments and industrial are doing better than office, hotel and retail properties, respectively. The problem this time around is a lack of demand, versus the excess supply that plagued prior downturns. In fact, the development pipeline is the lowest it's ever been in the survey's history. As one interviewee said, "Why build anything when you can buy existing real estate so much more cheaply?" In addition to credit and overleveraging issues, property owners have been facing a decline in tenant demand brought on by the recession. This, in turn, is impacting cash flows. As Blank said, "The credit crisis followed by the recession has really landed a one-two punch to the industry." These issues will continue as long as consumption and job growth stay on hold, and it looks like this will remain the case for some time. A recovery in the financial services industry is also necessary to jumpstart the market, with lenders taking write-downs on loans, as well as losses, to improve their balance sheets. "Pretend-and-extend strategies are only delaying the day of reckoning for many borrowers," said Blank. "Our respondents think in 2010, banks and special servicers will start to foreclose with greater frequency, and the FDIC is going to accelerate property sales and loans. Workouts will increase and more borrowers will give back the keys as they start to question why they should pay debt service coverage when the cash flows don't support property values." With bid-ask spreads narrowing, the pendulum will swing in favor of buyers. For those seeking distressed assets, particularly CMBS, Blank said the government will likely continue to provide credit facilities because it cannot allow a commercial real estate industry meltdown. "Once assets start to come to market, cash buyers are going to start to step in and we'll see some floor on pricing," he said. Wall Street will also get back into the game; industry executives expect to see more IPOs as private equity funds and owner-developers seek ways to recapitalize. "Like the early 90s, it's going to be either go public or go broke," commented Blank.

As interest rates move up with economic recovery, it will put excess pressure on cap rates. Caps are expected to rise about 45 basis points at the high end of the scale, and by the time the market settles down, cap rates for core property types are expecting to be in the range of about 7.5%. On the equity end, capital flows will continue to be moderately to severely undersupplied as investors wait for the market bottom—which isn't forecast until the middle of next year at the earliest, noted Miller. The good news is that REITs, which declined 75% off their market peaks of late 2006 to early 2007, have started to recover and should be in a relatively strong position to be accretive buyers at the market bottom. "They're also in a position to poach tenants from weaker, overleveraged private landlords," said Miller. "So the fact that REITs are coming back is a sign that there will be market recovery." "Debt is real issue," he pointed out. "Debt is severely constricted across board, and until the debt markets recover, we're going to have serious issues for real estate investment." Banks are not in a position to lend, and most believe the CMBS market has to recover for commercial real estate to come back and debt to flow into the system to generate activity. That, he stressed, is going to take a lot of time and effort to fix. For investors, cash and patience will be king in 2010 and 2011. Only the most liquid buyers can take advantage of the emerging opportunities, and patience will be rewarded. Miller maintained that getting into the game early isn't a smart move, as some of those early deals will turn out to be mistakes down the road. Investors should also focus on quality assets with debt maturity in high-tier markets such as New York, San Francisco and Washington, DC, which are among the gateway cities that will feel the impact of the recovery more quickly. The report's authors also warned investors to buy against real yields and cash flows as opposed to forecasts, and to focus on asset management and tenant retention for long-term value creation. **(Globest.com)**

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### **Metro Denver Apartment-Vacancy Rate Falls for First Time in Seven Quarters**

The apartment-vacancy rate for metro Denver fell to 7.4 percent during the third quarter, marking the first time it has fallen in seven quarters, according to a report released Wednesday. The vacancy rate is at its lowest level since the third quarter of last year, when it was 6.5 percent, according to the survey by the Apartment Association of Metro Denver and the Department of Local Affairs Division of Housing. In general, a vacancy rate of 5 percent is considered equilibrium. A drop in the unemployment rate and continued population increases are likely contributors to the declining vacancy rate, industry experts said. "There's no question we've seen good correlations between job growth and vacancy," said Lauren Brockman of Orion Real Estate Services. Metro Denver's unemployment rate peaked at the end of the second quarter and slowly fell in the third quarter, said Gordon Von Stroh, professor of business at the University of Denver. "The vacancy rate reflects this trend," he said. Arapahoe County and Denver tied for the highest countywide vacancy rate, at 8.5 percent. Douglas County reported the lowest rate, at 4.3 percent. Vacancy rates for other counties surveyed were: Adams, 6.7 percent; Boulder/Broomfield, 5.5 percent; and Jefferson, 6.3 percent. The average rent of \$882 was up from \$870 in the second quarter but down from \$892 in the same period a year ago. Only Arapahoe and Douglas counties reported increases in rents compared with the third quarter last year. The highest average rent was in Douglas County, at \$1,058, and the lowest was in Jefferson County, at \$818. Average rents for other counties were:

Adams, \$848; Arapahoe, \$862; Boulder/ Broomfield, \$951; and Denver, \$888.  
(Denver Post)

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	CURRENT	1 MONTH PRIOR	1 YEAR PRIOR
FED FUNDS RATE	.25	.25	1.00
3 MONTH LIBOR	.27	.28	2.15
PRIME RATE	3.25	3.25	4.00
10 YEAR TREASURY	3.43	3.43	3.83
30 YEAR TREASURY	4.36	4.26	4.34

