



GUEST EDITORIAL

2010 HOLDS PROMISE FOR COMMERCIAL REAL ESTATE MARKET

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No doubt 2009 was the most difficult year for commercial real estate in the United States. The credit markets and the fallouts from the housing crisis and its effect on the total economy have impacted all property types in every part of the country. Although, we are still facing extraordinary challenges and will see more fallout from this economic crisis, 2010 should be a brighter year for commercial real estate.

Instead of the extended period of economic malaise that was predicted by some economists, the weight of evidence shows that the economy returned to a modest growth by the 3rd quarter of 2009. Labor market indicators are showing stabilizing conditions, easing the anxiety over record job losses earlier in the year.

Looking forward, economists and industry leaders are cautiously optimistic about the measured growth predicted in the upcoming year. As the uneasiness about the job market subsides, consumer confidence and business health will continue to improve. Barring

unexpected setbacks, economists anticipate a sustainable job growth by the end of 2010. This is welcome news to those in the commercial real estate industry since demand for new commercial space is driven by the addition of jobs.

NATIONAL OUTLOOK

Commercial real estate investment sales were astonishingly low in 2009, starting at a low point at the beginning of the year but showing increased volume in the last two quarters. Annualized sales volume for 2009 was around \$60 billion. Some economists predict that 2010 will realize an annualized sales volume of just over \$70 billion.

Equity funds and public REITs will capture a larger share of the acquisition activity in 2010 than they did in the past year. However, private investors will continue to be involved in the bulk of transactions, with many of the properties trading at \$500,000 to \$2 million. Kevin Maggiacomo, CEO of Sperry Van Ness International, says that

this is “welcome news,” particularly for those whose focus has long been on properties in this price class.

Although the distressed asset market has fallen short of the expectations of opportunistic and equity investors, sales activity of this type of asset will increase as impediments to this market subside. Banks that have been unwilling or unable to liquidate problem loans will be in a better position to do so as other aspects of their business normalize. Further, it is predicted that the inevitable deterioration in cash flow that is resulting from current leaseholds will push the properties of over-leveraged owners into the distressed asset inventory pool.

According to Dr. Sam Chandran, President and Chief Economist of Real Estate Econometrics, the year-end default rate of commercial mortgages held by depository institutions is projected to increase in 2010 to the highest level since 1992. While a high percentage of sellers will be in some sort of distress, there will also be a category of seller who will find opportunity in selling during the first quarter of the year before the increase in inventory affects competition and pricing.

Certainly this year will provide many opportunities for the qualified investor. Maggiacomo lists three reasons that the buyer will make deals in 2010:

- *Buying real estate as a hedge against inflation:* And inflation is coming. While commercial real estate as a hedge against inflation is an invalid strategy when significant supply and demand imbalances exist (as they do today), long-term holds of properties in “A” markets can compensate investors for an inflation premium. Conversely, inflation will lead to higher interest rates, which can be disruptive to the market and negatively impact property values. Views on the subject differ, yet buyers will re-enter the commercial real estate market in 2010, citing hedges against inflation as their reasons for buying.
- *Low interest rates:* Interest rates are at historical low rates and are expected to remain low throughout the year. While credit availability still hinders some investors, cash rich equity funds and REITs will thrive in this environment. Group buying and seller financing will enable private investors to enter the market during this period of low interest rates.
- *Investors need to invest:* You can buy in to the investment grade bond market and earn a whopping 3.75%, or you can buy NNN leased, credit tenant real estate and more than double your return. As Bill Gross of global investment management firm PIMCO points out that the cost of capital sitting on the sidelines is an effective zero percent interest rate. “As a price for hiding in a foxhole, it is prohibitive,” he says. In 2010, buyers will exit the payless funds earning close to 0% in search of manageable risk. Quality commercial real estate will receive considerable attention in this context.

Because problems with debt structure will motivate a large number of sales, pricing will remain in flux in the next year.

As a result, headline measures of cap rates will fail as indicators of the underlying variation in property trades. Rather, buyers and sellers alike will be depending on their advisor’s knowledge of the market and of the emerging mechanisms of exchange, such as auctions, to guide their investment strategy. Investors with strong operational capabilities who are seeking to acquire assets over the next year are in an ideal position. This group will be able to purchase assets during a period of dislocation, before asset prices normalize and while long-term yields are at their peaks.

LOCAL OUTLOOK

When you look at the analysis of the trends for our area published by sites such as Reis and CoStar, the central Arkansas market will follow national trends in the upcoming year, although the recovery of our market may lag behind the national trends by a quarter or two. Fortunately, our local market has not seen the steep appreciation of property values followed by devastating crashes that the nation’s large markets have experienced. According to Reis, a company that publishes quarterly commercial real estate market reports, the greater Little Rock area will realize a peak in office, retail, and industrial real estate inventory mid-year.

The commercial real estate market is highly dependent on local factors. Metro areas that are the state capital, have a major university presence, and a military installation will outperform other areas that lack all three of these major economic drivers. In addition, tertiary markets are now the better places to invest and will outperform first and second tier metro areas. This all bodes well for central Arkansas.

It is important for sellers as well as buyers to hire a real estate professional who has encyclopedic knowledge of the local market, has connections to national networks to provide a platform for putting deals together, and offer more than just brokerage and leasing services.

Savvy investors would be wise to work with a true advisor who can provide the entire spectrum of real estate consulting and who has resources to bring expertise tailored to an investor’s specific requirements.



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