

**Great CoStar article on the National Commercial Real Estate Market and with analysis by Ted Jones, PhD, SVP-Chief Economist, Stewart Title Guaranty...**

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“Residential real estate agents and brokers thought the sky was falling when existing home sales dropped from 7.25 million on a Seasonally-Adjusted Annualized Rate (SAAR) in September 2005 to 4.49 million SAAR in January 2009—a reduction of 38.1 percent. In comparison to commercial’s plunge, the residential decline is akin to a mosquito on an elephant. Real Capital Analytics reported that total commercial sales activity in the U.S. dropped from \$557.8 billion in 2007 to a minuscule \$54.4 billion in 2009—a **whopping 90.2 percent implosion**.

Good news is that 2010 is shaping up to be better than 2009—but how could it be worse? Sales are finally picking up. Bad news is that it is most all driven by distressed properties. Good news is that the buying opportunity for commercial real estate today is the best it has been since the late 1980s. And fortunes were made by those focused investors that took the opportunity to acquire quality assets at bargain basement prices then. We will once again see fortunes made by the opportunities available today—and likely at least in the next 12 to 18 months.

Rather than the infamous, “Drivers, start your engines,” it is now, Buyers, make the offers.”

We will look back four to five years from now (if not sooner) and slap ourselves for not having bought more.”

Ted Jones --

**Full Article:**  
<http://www.costar.com/news/Article.aspx?id=8C266790CA452E014670C024977272F5>

# Signs of Hope Seen in Investment Sales Activity

2010 Institutional-Quality Property Sales Showing Year-over-Year Improvement in Many Categories

By [Mark Heschmeyer](#)

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Large dollar property sales seem to be emitting faint sparks of hope for the commercial real estate outlook so far in 2010, particularly in the multifamily and hospitality sectors.

To be certain, the number of property sales with price tags of \$5 million or more still declined 16% in January from the number of sales in January 2009, according to CoStar Group Inc. And that was a steeper decrease than seen in November and December.

However, that decrease in dollar volume can be attributed to fewer deals and smaller properties being sold. The average size of the properties sold this past January was 5% smaller than a year ago, and the number of deals was down 15%. That helped raise, the average price per square foot being paid for institutional-quality properties from \$141 per square foot to \$149 per square foot January to January, the third month in a row that the average price paid was more than it was in the year-earlier period.

**What's more, multifamily sales in the \$5 million and up category increased 50% over the year earlier. This was the second month out of the last three that multifamily sales had increased month over month. Apartment sales were up in November and flat in December.**

**Hospitality property sales also took a huge upward turn in January - up more than 250% over the year-earlier period. Although, it was the first monthly increase since the recession started, the trend over the last four months has clearly been improving for hotel properties. They were down 58% in October 2009 compared to October 2008, but down only 1% in the December-to-December period.**

While no one is jumping to the conclusion that the results clearly indicate commercial real estate has turned a corner, they do appear to lend more credence to the belief that a painfully slow rebound may be in progress.

"We'll see more transactions involving institutional quality property because buyers are beginning to understand that prices for top-quality properties may be at or near a bottom," said Bob Bach, chief economist at Grubb & Ellis. "I think we'll see a gradual increase in sales this year of perhaps 20% to 30% or possibly considerably more."

"We'll also see [more activity in] Class B and C troubled assets in secondary and tertiary markets because lenders realize there's no reason to hang on for better prices because these properties will be the last to recover," Bach said. "Prices are expected to drift moderately lower, more into the strike zone where buyers and sellers will start to make deals. But the pricing correction is [still] probably [only] two-thirds to three-quarters over with."

In addition to attractive pricing and lenders more willing to sell, confidence from the resumption of job growth is also expected to stimulate the willingness among investors to seek outsized returns by taking on greater risk.

As CoStar's Property and Portfolio Research (PPR) noted in its 2010 Predictions white paper, "Once we start getting a couple of months of positive job numbers, particularly if there is an accelerating trend, we're going to see a lot of investors interested in cashing in on the opportunities that are out there, whether this means acquiring half-empty buildings or taking on assets with big lease-roll exposures."

According to PPR, the best-performing opportunity funds from a vintage standpoint have been those that are executed in the last year of a recession or the first year of the recovery. Looking back to the last downturn, 2001 and 2002 vintage funds were the best-performing opportunity funds over the previous eight years.

## **Multifamily Investment Sales**

"There has undoubtedly been an uptick in transaction velocity in multifamily deals, and I believe it is due to a variety of factors," said Darron Kattan, partner and senior multifamily broker for Franklin Street Real Estate Services in Tampa, FL. "Multifamily is always the top choice of investment dollars and therefore there are a lot of buyers looking for deals. Nothing new in this cycle versus previous where multifamily is the first to recover due in large part to the availability of buyers. Multifamily was actually the first to hit the distressed radar screen, with the shortest term leases (outside of hotels), and therefore became the first to get hit hard by the downturn and land on asset managers' desks at lenders and servicing companies, and therefore are the first working through the system."

In addition, Kattan noted that AIMCO and Equity Residential were large net sellers in 2009 due to balance sheet and stock pricing issues. That, he said, opened the door for attractive deals to hit the market.

Tim Wang, vice president, senior investment strategist for ING Clarion in New York noted that Freddie Mac, Fannie Mae, and HUD have been dominating the multifamily financing.

"This is the only property sector that you can still lever up to 75% loan to value and have positive leverage to juice up investment returns," Wang said. "The Fed plans to end its \$1.25 trillion mortgage debt purchase program by the end of next month, which could potentially lead to an increase in GSE mortgage rates. So, there is a rush in the marketplace to take advantage of the attractive financing terms and do multifamily deals before this deadline."

## **Hospitality Investment Sales**

"Hotel demand is highly correlated with economic growth," Wang said. "Historically, it is one of the first property sectors to recover after recession. The sector is definitely improving, albeit from probably the steepest downturn in the U.S. lodging industry history. We are seeing generally stabilized occupancy while the average daily room rate is still declining but at a slower rate. The major difference in this downturn is that there was excess hotel supply delivered to the market in 2008-2009. Consequently, the revenue per available room recovery this time around could be slower than in the past."

Gordon L Wicker, chief operations officer for AXIA Real Estate Appraisers in Tucson, AZ, said, "with respect to the hospitality market statewide, average daily room rates and average daily occupancies remain well off 2007 numbers, so most sales activity in the larger regional/national market appears to be an increase in activity from REITs both as a long-term investment, and also due to a lack of attractive investment alternatives."

Timothy D. Chamberlain, principal at Koda Ventures LLC, and senior director at Lee Kennedy Co. Inc. in Quincy, MA, also noted that hospitality, while still distressed, is becoming appropriately priced.

"Hospitality is discounted enough to start to move and apartments represent stabilized cash flow, which is what the market wants today," Chamberlain said. "All other classes are getting kicked down the road and are not yet priced appropriately for a reasonable risk adjusted return."

Office, Industrial and Retail Investment Sales

"There will be an uptick in volume in 2010, but not much," Chamberlain said. "2011-'12 will be an active years for the industrial, office and retail food groups."

Of the three primary commercial real estate property sectors, 2010 investment sales numbers seem to indicate that office properties have improved the most over 2009. For starters, the pace at which sales have been declining has slowed dramatically. October 2009 sales were 50% fewer than they were in October 2008. That dropped to 24% fewer for December 2009 over December 2008. And in January of this year, office property sales of \$5 million and up were off just 6% from what they were a year earlier. Notably, the average price per square foot is down dramatically from what it was a year ago: \$158 compared to \$202.

Retail and industrial property sales were still way down from year earlier numbers. Retail sales in January totaled 38% less the year-earlier period and industrial sales declined 68% month over month.

"Retail will generally continue to struggle until investors can get a feel for when occupancy rates and net operating incomes will stop deteriorating," said Mac McCall, senior director of Franklin Street Real Estate Services in Atlanta, GA. "With many retailers continuing to see declining sales, especially mom and pops, vacancy rates will

continue to tick up without the added boost of increased employment in the overall economy."

"Additionally," McCall continued, "if you factor in the potential of bank-owned retail properties hitting the market in the coming years, buyers of this product will be able to get away with charging lower rents because their acquisition basis is much lower than their neighboring properties which were either built or acquired during the peak of the cycle and therefore have to charge higher rents to justify their mortgage payments. Both of these key factors make it a tough sell to a potential investor to invest in an asset with so much uncertainty regarding future cash flows."

Manish Rajguru, who oversees the evaluation of CMBS and other CRE debt instruments at Red Pine Advisors LLC in New York, said that, "the industrial [property sector] should increase, especially those related to trade (exports in particular). The office and retail property sectors should continue to lag given uncertainty of growth in office using employment and consumer respectively (and General Growth Properties' fallout as some malls will have to be repositioned/closed)."

## **Buyer Demographics**

The buyer profile of institutional quality properties has shifted in the last four months from what it was a year earlier. Developer/owner and investment manager buyers continue to be the primary buyers of properties and, in fact, have increased their outlay year over year. Developer/owner purchases were up to about \$7.3 billion in the last four months compared to \$6.8 billion in the same period a year earlier; and investment manager buys were up to \$5.5 billion from \$3.7 billion.

REITs and corporate buyer have decreased their buying activity in the last four months from a year ago. REIT activity was down slightly from \$5.4 billion to \$5 billion; and corporate buying activity was down from \$3.5 billion to \$2.6 billion.

Notably, it appears that banks and financial institutions have stepped up their foreclosure activity. Bank/finance firms accounted for \$1.9 billion in purchases in the last four months up from \$480 million in the same period a year earlier.