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New England SIOR Chapter holds 2nd Breakfast Series Event

April 06, 2010 - Spotlights

The New England Chapter of SIOR held its second chapter event with its popular Breakfast Series Event. The breakfast was held Wednesday, February 24th at the Newton Marriott for approximately 30 SIOR members and their guests. The speaker was Paul Marcus from Marcus Partners who focused on the status of investment real estate. Marcus Partners is based in Boston with regional offices in Norwalk, Conn. and Tampa, Fla. The firm invests in real estate or related assets, pursuing a mix of strategic and opportunistic investment strategies. Marcus Partners is experienced in the complexities of real estate and the capital markets. Marcus Partners focuses on complex financial transactions in today's real estate environment and is currently investing its Marcus Capital Partners Fund I into a diversified portfolio of office, bio-medical, medical office, and light industrial properties in major metropolitan areas primarily east of the Mississippi River. Paul is a graduate of MIT.

Chapter president Greg Klemmer welcomed the audience and gave a succinct summary of the upcoming April 28th Newton Marriott Breakfast and the SIOR Annual Golf Outing at Turner Hill on May 27th. Klemmer also announced that he wanted the Chapter to be more involved with a charity and has suggested the Big Brother/Big Sister organization. The Chapter plans to meet with Big Brother/Big Sister for SIOR Chapter members who want to hear more details. Typically a Big Brother meets 1-2 times a month for 1.5-2 hours per meeting with a teenager that needs mentoring. Klemmer then introduced Paul Marcus.

Marcus concluded at the beginning of his lecture that there will be a "new normal" in the next two years and a restructuring of the economic order. The way business plans "grow and think" will change for the good and for the bad but an investor needs to be in the right place for these upcoming changes. He stated that the U.S. remains in a recession but the way we are coming out of this recession will be very different than from past recessions. The way we do business will be very different than the other recessions but we will come out of this recession. Marcus was able to raise \$225 million in equity last April 2009 during "Armageddon" which shows that cash is ready to go.

Marcus then referenced an MIT study and chart on the economy that could suggest where this current opportunity will take us. The economy peaked in 1987 and bottomed during the 3Q of 1992 in terms of values. We then experienced a 5-year decline in real estate values. Then the asset bubble occurred by 2006 and Marcus thought prices were crazy high then. In fact he removed 80% of his potential purchases off the "table". We still have a ways to go down in his opinion based on opportunities and cap rates. How bad will it be? It depends on the U.S. confidence level, etc. Real estate is down 40% from its peak in 2006.

Where will we see values?

Marcus concluded that distressed properties are increasing. The majority of real estate debt is owned by banks and not the CMBS market and it's the banks we need to watch. The supply and demand of capital issues and fundamentals are changing. A bigger issue is the capital.

The Funding Gap

Marcus stated that we are past the massive turning point of "hitting bottom" and now we need to decide how to deal with the capital issue. There is a \$26 million equity shortfall with owned investment real estate. He gave an example of properties financed five years ago at 75-25% LTV and that new values are 51% less creating an equity shortfall of \$26 million. The market will experience these problems related to this shortfall and it will take 4-5 years to work out this equity issue. In the early 1990s it took real estate 2.5 years to recover after job growth began. But right now job growth has last and extrapolates to 2010.

Where is investment real estate today?

Marcus stated that investors are raising capital in the amount of \$50-60 billion so there is money out there but not much real estate supply. There is very little inventory so money is coming off the target. Real estate will get tougher and not better in the next few years. Tenant improvement money is being used up as well.

When does real estate bottom?

The leasing rates and values bottom historically at about the same time. The office side, he sees bottoming in 2010-12. The greater Boston rental rates will bottom late in 2010 or 3Q 2011. The rental rates might drop another 10% or more for Class A and for Class B office space. Medical space has done better than most assets. Inflation will help some properties and will hurt other types of properties. The institutional property owners will be having problems as well. Tenants trying to obtain SNDA language from institutional owners will be difficult. 2010 will be the beginning of the "Revolution."

Marcus then reviewed the S&L Crisis in 1989 to the Dotcom era in 2000 to today's 2010 status. He felt that the low space demand/high vacancy issue is worse in general than an oversupply issue. And the market is in a low demand scenario. To solve this problem, Marcus felt that Massachusetts needs to work and focus on keeping college students here in the state and help the economy grow. For the next two years, the real estate industry will be in a volatile market. Prices will spike in the next few months and then a flood of properties will hit the market. We will hear great news and bad news constantly but not consistent news. News will be quick so investors need to be prepared for volatility and pricing volatility.

Current Investment Strategies

In concluding his presentation, Marcus felt that there are two types of real estate investment choices: Assets returning to lenders which he felt could be minimal. The other choice is the majority of investments that will be negotiated between borrower and new equity buyer and with the existing debt holder. The new opportunities will be with existing borrowers and more than 50% of transactions will be with these existing owners. Most properties will not hit the market. We are still early in the down cycle and the last down cycle took us five years to recover. So we need to be patient.