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Trends of the second half of 2007 provide us with several clues for 2008

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As I meet with my fellow brokers, institutional and private clients, and lenders, I get two questions more than any others: 1) When is Joe Paterno (JoPa to fellow Penn Staters) going to retire? and 2) What will happen in the real estate market in 2008? While only Joe knows the answer to the first question, I believe the trends of the second half of 2007 provide us with several clues for 2008.

Have things changed in the Capital Markets? Absolutely. Sub-prime has become a scourge that is responsible for the financial market woes. Goldman Sachs commented in November that mortgage losses could reach \$400 billion, while major players like Citigroup and Merrill Lynch saw leadership shake-ups as a result. Sub-prime bailouts, tighter lending requirements (lower leverage, higher reserves), more conservative underwriting, and uncertainty in the political and economic arenas may make us long for the halcyon days of 2004 - 2006. There is also a legitimate concern over the level of liquidity in the marketplace and what effect that will have on value. Many buyers are opting for current yield over IRR, and as a result value has been defined more increasingly by future NOI growth over cap rate compression.

But the good news is that these negative events haven't changed the core fundamentals of real estate. By historical standards, the 4%± 10-year treasury is still very attractive and has cushioned some of the increasing spreads quoted by lenders. Unemployment remains low, job numbers remain solid and profits overall are strong on Wall Street. If the early returns on the holiday shopping season are any indicator, consumers continue to spend. Real office market rent growth, particularly in the tri-state region, is justifying new ground-up development. There is limited quality office space available in Manhattan, which continues to push firms out to the suburban tri-state markets. Over the past 12 months, we've seen strong average asking rent growth in markets like midtown Manhattan (up 34.8%) and Greenwich (55.1%), which in turn is pushing tenants out to areas like Jersey City (15%) and White Plains CBD (22.6%).

While no one knows for sure what lies ahead in 2008, here are some trends from the second half of 2007 that should continue in the coming year:

More Recapitalizations: Entering into a joint-venture relationship on a recapitalization basis can be a win-win for everyone involved. The new investor typically gets a stable return (sometimes preferred) and a managing partner with experience in the asset while avoiding day-to-day operational issues, and the managing investor gets an influx of capital, retains management and minimizes tax exposure.

All Cash buyers, lower leverage, surety to close: I may be the first broker willing to put these words in print, but some sellers are valuing buyers who require no or low leverage and offer surety to close as much as buyers who offer the highest price. The instability in the credit markets has created a situation in which sellers and buyers alike cannot be sure that the credit terms they are quoted in the

morning will hold true later that same day.

Foreign Capital Influx: It seems like each day marks another record for the Euro against the U.S. dollar (\$1.44 per Euro as of December 17, 2007). Even the Canadian dollar, lovingly referred to as the "looney", has floated around a price worth more than our beloved greenback. What this has meant for a while now, and should extend into 2008, is that U.S. real estate continues to be available at a discount, particularly relative to European real estate. We've seen large pools of foreign capital, especially German capital, on the lookout for deals over the past 18 months. Foreign capital, however, is particular about what they want to buy: Class A trophy properties in top 10 or so office markets with strong in-place cash flow.

Prime-Located, Trophy Assets with stable cash flow still in vogue: Consistent with previous periods of market instability, there has been a flight to quality. This was best exemplified by our recent sale of 55 Railroad Ave. in Greenwich which traded for \$142.5 million or \$1,083 per s/f, the highest price per s/f ever paid for a suburban office property.

Real Office Rent Growth: After a long period of marginal rent growth, we have experienced very strong rental growth throughout much of the region. This rent growth has helped to solidify property fundamentals, thereby alleviating some of the debt risk and pricing concern in the capital markets. Office rent growth in 2008 will likely be more muted, particularly in New Jersey where the availability rate is still over 17.5%. The average asking rent in many markets of the Tri-State region has grown considerably over the past 12 months, led by Greenwich and Midtown Manhattan.

As for predictions, I leave you with this final thought from Warren Buffett: "In the business world, the rearview mirror is always clearer than the windshield."

Jeffrey Dunne, vice chairman (assisted by Chris Leonard, associate) of CB Richard Ellis, Stamford, Conn.