nerej
19 63 CELEBRATING 55 YEARS

Commercial Real Estate...You are not in 2010 Anymore, Dorothy

April 24, 2014 - Spotlights

Commercial Real Estate - CRE - is a nice place to be if you are to be in real estate. Housing markets are up and down, feast or famine. The government gets very involved with housing, which only makes for new problems. CRE chugs along in 2014. It's not 2010 anymore.

What are some of the main concerns, in a general sense, that we should have about CRE markets?

A recent edition of a major survey notes that "willing buyers outnumber quality offerings..."

The survey goes on to say that "investors are well capitalized, eager to place funds in the commercial real estate industry, and optimistic about the future." What is needed, however, are more "quality offerings to come to market." The survey reports that this appears to be a common theme - a lack of good product for purchase - within specific property sectors and within many geographies.

This appears to be true both at investment grade and main street levels, and in between. However, there is some geographic variability at the mid- and lower ends of the markets. At the lower market tiers, there is a shortage of good quality assets available for purchase - but no shortage of overprice, underperforming, poor quality assets to acquire.

There's plenty of money sloshing around in the system. For a long time, the bankers kept their hands in their pockets, not always out of choice, but, often, out of necessity. The best lenders are competing robustly for the best deals. The rest of the lenders hope to tie up some high quality, low risk deals and sometimes they do. There are clearly too many partygoers to fit in the room. Some lenders are still trying to make sense of the market and don't realize it's no longer 2010.

William Pastuszek, Jr., MAI, SRA is the principal of Shepherd Associates, in Newton, Mass.

The Fed promised that rates would rise and that quantitative easing would wind down. Last year rates rose. Commercial markets hiccupped but quickly recovered as prices, rents, and, most importantly, optimism were on upward tracks. The Fed promises to be transparent and predicable. Predictable is good. Risk is inevitable. Uncertainty is bad.

All those distressed properties look like great opportunities now. Much maturing debt has gotten quietly refinanced or put into further workout cycling. Much of the underwater collateral floated to the surface, somewhat worse for wear but ready for the next cycle.

The promised nuclear debt event no longer hangs over markets as much as it once did: there is not the unreasoning fear that the great bulge of debt would "bury" a recovery. A lot of debt may come due in the next year or so but there isn't a great deal of advance hand wringing about it. There is value in the underlying collateral, there are tenants actually willing to pay rent again and sign leases that mean something, and there is NOI that can service debt.

The cap rate compression that occurred has mostly slowed to a crawl in most locations and property types. Cap rates, with some local and specific exceptions, are likely to remain reasonably stable going forward, or, at least not go down much more.

Given product shortages, and revived tenant demand for space, development and new construction is taking in strong urban centers. The classic relationship between the cost of acquiring existing product or creating new product at a competitive cost is at work again.

With continuing intelligent investor activity and a fundamentally sound economy, commercial real estate should continue to experience very favorable market conditions and will remain the darling of investments in an economy within limited high yield, reasonable risk opportunities.