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Small mutual banks seem to be doing well with increased loan demand, but have competition

September 05, 2008 - Northern New England

Even if "the worst is behind us" history tells us that those words should never be uttered. All of the following leaders/CEOs expressed exactly those sentiments before reporting huge losses or suffering personal setbacks. (see graphic)

The New England Chapter of NAIOP Mid-Year Roundup featured a panel of distinguished officers and brokers, who are the local representatives of the largest national commercial real estate firms. The panel was virtually unanimous in its belief that the New England commercial real estate markets, and particularly Boston, were faring well in occupancies and rent. In their opinions, cap rates had moved slightly upward but were holding near record lows, and that transactions were merely taking longer to close. If they are correct, for the first time in recent history New England is out-performing the national commercial real estate markets. A look at the national markets says that commercial real estate is in decline. Real Capital Analytics indicates capitalization rates increasing across all major property types.

The canary in the mineshaft for commercial real estate is retail. At the national level, according to Richard Bach of CBRE Grubb & Ellis, tenants are beginning to have the upper hand. Vacancies in neighborhood centers were at 7.7% at the end of the first quarter. This represented the highest vacancy rate in 12 years and the 12th consecutive quarter of flat or deteriorating occupancy. The International Council of Shopping Centers reported that the first quarter of 2008 indicated negative absorption of 1.2 million s/f, the first quarter of negative absorption since 2003. The Council forecasted 5,770 store closings in 2008, up nearly 25% from 2007.

Office space nationally is likewise showing some weakness. The National Association of Realtors and CBRE Torto/Wheaton reported vacancy up to 12.8%, slowing rent growth and absorption down 1.7 million s/f.

One of two bright spots on the national level is industrial/warehouse which historically has shown less fluctuation in demand. While vacancy was up slightly to 9.7% from 9.5%, rents were expected to increase 2.1% to $4.80 per s/f. The port markets are performing exceptionally well due to the expansion of international trade.

According to the U.S. Census Bureau, the other apparent bright spot nationally is the apartment market, where vacancy has held at 10.1%. Regional differences are greater in apartments than any other product, with vacancy in the west and northeast at 6.5% and 7.1% respectively, while the midwest and the south stand at 12.1% and 13.1%.

Medical office may be another niche to play in, as 3 out of 10 new jobs created in the next 7 years will be in healthcare.

The Boston District of the Federal Reserve reported that respondents to its capital markets survey indicated that portfolio lenders - life companies and commercial banks continued originating commercial mortgages as Wall Street investment banks remained dormant and lending standards were relatively stringent.

The Beige Book said, "Commercial real estate contacts report that the Boston office building market which was largely dormant in the first quarter, has seen a number of properties come up for sale in recent weeks; however, one contact notes that the number of closed transactions has not yet edged up significantly."

Small mutual banks seem to be doing well with increased loan demand, but are expecting increased competition from Wall Street at year-end. Freddie Mac and Fannie Mae however are having a record year in the multi-family lending arena.

The Boston District said it expects market conditions to turn around at the end of the fourth quarter of this year or the first quarter of 2009. Q|10 New England Realty Resources agrees with the Fed. Regulators are looking closely at bank lending for commercial real estate and the life insurance industry will not have sufficient capital to fill the void in lending.

Nonetheless, if you are the owner of investment grade real estate, willing to accept the new valuation era and a conservative loan to value, your deal will be done at an attractive interest rate in the low to mid 6% range. Historically that's a pretty good deal! Financing now is a good choice.

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