

LAI Arizona “Emerging Trends in Real Estate”

By Cynthia A. Hammond, LAI Arizona Scribe, President, Churchill Commercial Capital

“Emerging Trends in Real Estate 2011” was the topic of the LAI Arizona chapter’s meeting on November 11th. Chuck DiRocco of Pricewaterhouse Coopers presented the overview of the 2011 forecast, gleaned from more than 875 interviews conducted nationwide covering key market participant’s views on the future of our property markets and economy. A local panel of experts followed DiRocco’s presentation, addressing Arizona trends for the property markets.

“The Era of Less” is an apt description of the tone of the 2011 Emerging Trends forecast. Tempered improvement is anticipated, as lenders finally begin to recognize losses (30-50% below 2007 peaks), allowing transaction volume to increase. Investors and lenders will flock to “core” assets in 24 hour, often coastal cities. The best properties with healthy ownership will garner competition from equity and debt investors, while properties in many interior markets struggle to attract capital. Investors with cash and low leverage are in an optimal position to reap rewards, albeit not necessarily at earlier anticipated high double digit returns, from acquiring assets and recapitalizing highly leveraged owners of good real estate. “The haves can attract new capital, poach tenants and lure talent from the have-nots”. Return is to be reaped from strong property performance, as opposed to leverage and flipping.

However, as one market participant stated, “Our problems are much bigger than real estate, and solutions are well beyond the scope of our industry”. Factors that may slow any rebound include continued high un and underemployment, stagnant wages, high savings as the middle class and businesses de-leverage (and its corollary, reduced consumer spending), continued tight credit, and rising taxes. The impending debt bomb, as hundreds of billions of dollars in commercial property loans mature over the next four years, cause many to predict a slow, bumpy recovery, and possibly even an inflection point (leading down) in American incomes and standard of living. Not a pretty picture!

Apartments, followed by warehouses in global commerce pathways, and infill grocery-anchored retail ranked highest by surveyed core investors. Full service, central city hotels earn top ranking among opportunity investors, with suburban office ranking near the bottom. Top ranked cities for investment are Washington D.C., New York City, San Francisco, Boston and Seattle. All of these cities are 24 hour gateways along global pathways, which attract higher paying, knowledge workers.

BethJo Zeitzer, president of ROI Properties moderated a local panel composed of Jim Belfiore (president, Belfiore Real Estate Consulting), John Fortini (president, Silver Fern Management) and Chris Toci (Executive Director, Cushman & Wakefield). The discussion began with the housing market. Metro Phoenix’s housing market collapsed in late 2005. Now, in 2010, homebuilder inventories are at very low levels, and finished lot inventories are getting depleted. Panelists expect 2011 to bring the re-trade of finished lots acquired in 2007, with hedge funds buying land portfolios. Raw land is being acquired by homebuilders who believe they can compete profitably with the re-sales, typically in lower priced product.

Foreclosures this year have hit a new record at 65,000; this inventory must be sold before the housing market can truly recover. Housing demand hit bottom in the 1st quarter 2008. Today, resale inventory stands at 45,000 with listings up 22% over the past year, and 75-90% of sales being of resale homes. New homes are selling at the rate of 1 to 1.5 units per month, with builders like Maracay branding their homes and effectively competing with the onslaught of foreclosure resales.

Toci summarized the commercial property forecast, beginning with the owner occupied segment. Commercial real estate is driven by jobs. Homes are the most affordable in a decade, with prices down 52% from the peak. This affordability is driving recent job growth of 15,100 jobs year over year, versus last year's loss of 171,000 jobs. But, credit for small businesses is frozen, and small business owners don't have credit card capacity to capitalize their businesses. The result is low demand for small business, owner occupied real estate, with condo sales occurring at \$70 to \$90 per square foot. Creditworthy users from growing economic sectors (such as healthcare and education) are active in the Phoenix market, drawn by sunshine and affordability. Strongest activity is in spaces of 10,000 to 20,000 square feet.

Opportunistic investors are circling metro Phoenix for investment properties. One class A-, large multi tenant office property located on the Camelback Corridor is on the market, with 192 offering memorandums sent, 20 offers received, and three rounds of bidding. Core buyers lag, with little interest in metro Phoenix yet. Once job growth is entrenched, the core buyers will return. Lack of demand and high vacancy leads Toci to believe that new office construction will not occur for 5 years. Meanwhile, office vacancies should drop 2-3% per year due to natural growth. Buyers consist of hedge funds, for high vacancy product, and REITS and pension funds for stable, well located assets. The chasm is large between the stable "good" properties and the higher vacancy real estate. But good opportunities are expected in 2011 and 2012, with Phoenix's intrinsic fundamentals remaining intact.