

“The Rumors Are True, Capital is Back!”

by Matt Baron, NAIOP Chicago Staff Writer

This is a summary of the June 10, 2010, meeting of the Chicago chapter of NAIOP, the Commercial Real Estate Development Association.

Its members gathered at the Riverway Auditorium in Rosemont to hear insights from moderator John Clifford, vice chairman, CBRE Melody and panelists John Huguenard, Managing Director/Co-Head, Jones Lang LaSalle; Gary Nussbaum, Managing Director, Eastdil Secured; John Gavin, Executive Vice President, Grubb & Ellis Company; and James Carpenter, Senior Director, Cushman & Wakefield.

The biggest cheers came at the outset of this NAIOP session—all moderator John Clifford had to do was mention what was on most everybody’s mind: the Chicago Blackhawks’ victory on Wednesday night.

The triumph secured the club’s first Stanley Cup trophy in 49 years, capping a remarkable turnaround from a struggling squad that routinely missed the playoffs until only a few years ago.

By contrast, and despite affirming that capital indeed is back (to a degree), nobody on this day predicted any imminent return to the robust days of real estate development. For students of recent economic history, that epoch would include the heady 2005 to 2007 period.

Instead, speakers expressed cautious optimism that there would be an upswing in real estate development over the coming months and into the next few years. Based on the relative stagnation in the market, they acknowledged, that isn’t necessarily saying much.

As Clifford noted, the entirety of downtown Chicago had only one major deal last year, at [303 W. Madison](#). Now a number of office buildings are going up for sale and there is \$2 billion worth of property on the market.

“Sellers right now have realized there’s a market for their buildings,” said John Gavin of Grubb & Ellis. “Advisers have said to them, ‘Get it while you can.’”

Gary Nussbaum, of Eastdil Secured, said another key is that there is “so much available equity for core deals.” Places like San Francisco, Seattle, New York and Washington, D.C., have seen more deals done, and “debt markets are increasingly supporting these transactions with more aggressive terms.”

Although economic recovery isn’t built into the underwriting for another one or two years, eventual rent growth is projected in ways that reflect “underwriting is also getting more aggressive...people are just pushing their underwriting a little bit harder,” Nussbaum noted. That aggressiveness, he said, is “more difficult with B and older properties.”

“Stability is what is driving it on the core side.....the need for stable cash flow is what’s driving these deals,” Nussbaum added.

Meanwhile, many sellers are taking the approach that “if they don’t need to sell, they won’t sell until the fundamentals are there nationally,” said John Huguenard of Jones Lang LaSalle.

In the suburbs, there has been such scant activity that by and large the projections being made amount to “speculating,” Gavin observed. He later added, “People seem to think there will be a normal market in three to five years.”

Echoing a sentiment voiced in prior NAIOP Chicago panel discussions, speakers emphasized the advantages that A-grade properties have in the marketplace. “The leverage is really for A-property core product,” Huguenard said. Most lenders are not pursuing B-grade properties.

In the suburbs, the transaction pipeline is filling up now. Gavin said five to seven deals could be made in the suburbs over the next two weeks: “Deal flow forecasts have changed a lot in the last 60 days.”

The prospective seller profile ranges from bank liquidations and private investors who have reached the end of their “hold” period, said Gavin. All are trying to capitalize on the market’s “scarcity premium,” Gavin added.

“Most value plays are all cash,” he noted.

Bidding is ramping up, too, thanks largely to increased ability to obtain financing that “would drive the depth and breadth of investors looking at it, at least,” Nussbaum said. He pointed to the [Aboretum Lakes](#) sale in Lisle during the first quarter of 2009. The pool of bidders “would have at least doubled,” Nussbaum predicted, if it had been on the market in late 2009 or early 2010.

More private equity is entering the market, panelists said. High net worth individuals who “don’t have committees” that tend to steer clear of risk are part of this equation, said James Carpenter of Cushman & Wakefield.

“Private people are best mentally equipped to take risk,” Carpenter added.

Gavin said that if he were a private investor, he would be frustrated, because the pricing of properties does not reflect the economy’s distress. For these individuals, then, the key is to be patient and wait for the eventual re-setting of prices, Gavin advised.

When prompted for their outlook by Clifford, most panelists predicted more activity in the second half of 2010.

Nussbaum said that it was not only Chicago, but other cities in the Midwest, such as Minneapolis, Indianapolis and Milwaukee, that stood to experience “busier, bigger deals” as “private REITs getting priced out of the coasts are looking for opportunities here now.”

He said a 380,000-square-foot development in Richfield, near Minneapolis, has the same pricing that Chicago would have.

Gavin ticked off data points (such as downtown deals amounting to \$185 million last year, but \$1.5 billion on the market now) as he forecast “a tremendous amount of deal flow pick-up.” The current timeframe, he predicted, will prove to be a “tipping point” toward returning deal flow to its normal level.

Carpenter, however, said he believes deal flow will stay at its current level. “People are starting to test the market for larger portfolios... There’s some large industrial portfolios rumbling around. How many of those will actually happen, I don’t know.”

Nussbaum said “the fundamentals are horrendous” now and another discouraging factor is that there is “very little economic data about job growth.”

“There’s a certain amount of contrarian mentality you have to take right now, some risk you are willing to take,” said Nussbaum.

In order to get deals done now, underwriters are banking on an improvement in the economy over the next year or two. But as the economic woes of the past few years have harshly reminded us all, there are no guarantees.

The final query, from an audience member, focused on the biggest challenge confronting the industry on the operational side. “Zero job growth” and “future job growth” came the replies from the panel.

Then it was left to Carpenter to utter the discussion’s final words.

Shedding the light-hearted tone that he had previously employed more than a few times, Carpenter firmly intoned, "Vote in November."

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