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COMMERCIAL REAL ESTATE DEVELOPMENT ASSOCIATION
CHICAGO CHAPTER

View From the Top: Leading Commercial Real Estate Capital Markets Executives Share Investment Views of Chicago

by Matt Baron, NAIOP Chicago Staff Writer

This is a summary of the September 24, 2014, meeting of the Chicago chapter of NAIOP, the Commercial Real Estate Development Association.

Its members gathered at The University Club of Chicago to hear insights from a panel of top executives on domestic and global investment activity and how Chicago's investment activity and opportunity compares.

The moderator for the panel was Brian McAuliffe, *Senior Managing Director,* CBRE Capital Markets, and panelists were Tim Ellsworth**,** *Head of Transactions for the Americas,* RREEF; Ted Willcocks, *Global Head of Asset Management*, Manulife Real Estate; and Mark Wilsmann, *Managing Director / Head of Real Estate Equity Investments*, MetLife Real Estate Investors.

Domestic and global investment activity in 2014 comes with shades of the pre-meltdown year of 2007. But there are enough differences to provide reassurance that we have learned from the mistakes that led to the global financial crisis.

At the same time, Chicago represents a stable, if relatively unspectacular, market that figures to attract growing interest from investment suitors in the coming years.

Those represent some of the conclusions conveyed by panelists during this well-attended NAIOP luncheon.

Regarding the 2007 vs. 2014 views, Mark Wilsmann noted that data should be drawn from both historical and relative contexts. From a historical standpoint, transaction volumes, yields and cap rates have returned to levels similar to seven years ago, he said.

In addition, some underwriting standards are "possibly kind of heading there" and in certain markets, vacant space is being valued even higher than occupied space, which Wilsmann termed "a warning sign."

But, relatively speaking, "real estate looks fairly priced," he added.

An important distinction he made is that in 2007, a lot of financial activity was driven by the debt market, with excessive levels of leverage and mispricing of risk. Today, there are not those “scary leverage levels,” Wilsmann observed.

Ted Willcocks added that there currently is a lot more governance and discipline in the marketplace. “It’s a much more disciplined environment” today, he said.

One encouraging barometer, Tim Ellsworth pointed out, came recently when only one bank agreed to be a lender on a recent purchase involving his company on a vacant building in Beverly Hills.

Although some observers may see it as a concern that just one bank was willing to get into the mix, “I think that’s a good sign,” Ellsworth said. The rationale: his company believes it is “ahead of the debt markets” and has confidence in its decision-making process.

McAuliffe observed that many players in the multi-family market have “hit or exceeded historic levels” in rental costs amid a “very slow, sluggish recovery in the economy.”

One outgrowth of the economy’s sputtering ways, according to Wilsmann: “We are in this continued environment where zero interest rate policies and the amount of capital in the marketplace looking to get invested are causing investors to take more risk to achieve the same deal.”

In response to a query about how the commercial real estate industry is changing globally, Wilsmann said that one of the biggest trends is how attractive the United States has become for foreign investors. He cited the Asian, European and Middle Eastern markets as three examples.

By contrast, in 2007 the trend was to invest in places like China and Brazil, he said.

“It’s a very attractive time for United States real estate,” Wilsmann said. “(However), it makes it harder as a U.S. investor to compete with those guys.”

Ellsworth chimed in that his firm now has significantly more foreign assets under management than 10 years ago and countries like Japan and China still have not nearly tapped into their potential to invest in the U.S.—to the tune of $40 billion for China.

Earlier this month, McAuliffe noted, two Chinese investors vied for an eight-acre tract of land across the street from the Los Angeles Country Club. The sale price: $420 million.

“There is so much foreign capital coming into the U.S. It’s unprecedented,” McAuliffe added. “Are you guys afraid?”

On the contrary, panelists took an opportunistic stance toward the intense foreign interest.

With a 49-percent cap for foreign investors on purchasing real estate, part of the approach now is for U.S. companies to leverage that capital for their own benefit, said Wilsmann.

“The strategy now is finding compatible sources and a structure that we feel comfortable investing in…and using capital to access larger projects,” he continued.

The large investments reflect a long-term outlook by investors whose decisions are part of a portfolio matched against liabilities over the next 80 or 100 years, Wilsmann said.

As for the Chicago market, Ellsworth said it has not seen the kind of rent growth that the East and West coasts have experienced, a continuation of a longstanding pattern. Panelists said the city is more stable, less subject to volatility, than other parts of the country.

Willcocks said he is bullish on job growth in Chicago, which in turn supplies rent growth. “We’re very keen on the prospects” in Chicago, he said, noting positive development such as the “tech incubation” under way.

“We think fundamentally it’s a wonderful market to invest in,” Willcocks added

Chicago has benefited from urbanization trends that are afoot all over the U.S., Wilsmann said, and the city continues to become a “more desirable place to live and to work.”

“We feel good about that,” he added. “It’s a deep market with high-quality (real estate) stock…We view it as certainly a very attractive market to place debt.”

Over the next 18 months, Willcocks predicted, Chicago will “get on the radar of foreign investors” in a much bigger way. “This city has changed so much recently…the mayor has done a wonderful job of bringing back (its) vitality.”

Nationally, there has been a structural shift in the multi-family sector, with more people looking to live longer in rental communities, said McAuliffe. As part of that trend, there is heightened desire to live in urban settings where a car isn’t necessary and people can work, play, dine and have their other needs and wants met.

Crucial questions yet to be answered in Chicago: how many children will be born to Millennials and how many will choose to remain in the city as their children reach school age? The answer, panelists said, hinges in large part on whether the Chicago Public School system is able to rise above its longstanding quality struggle.

Another trend to watch is the shift in how work space is used. To some degree, it’s an “equity equation,” Willcocks said. His company is reducing its office space by 30 percent across the world and, he added, “that trend is irreversible.”

Although technology and a desire for efficiency are partially responsible for the shift toward less office space, there is another factor with rising impact, according to Wilsmann: “How can you create an environment that is most productive for Millennials?”

He sees the pendulum has swung so much toward fitting more workers into less space that it will swing back toward somewhat larger spaces “creating environments to attract the next generation of workers and to make them as productive as you can.”

Panelists were also asked to remark on the impact that the outcome of political races will have on the marketplace.

Nobody advocated one individual or party over another. Wilsmann said that whoever is in charge politically, “we would love to see a slow, gradual increase in interest rates—nothing to shock the system but to get back to a true market base.”

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