Buyers Are

Back

Investors step into the light in search of safe bets.

by Beth Mattson-Teig

Commercial real estate investors are lumbering out of the woods and back into the game. The menagerie of buyers shopping for properties in today's market runs the gamut from private individuals to billion-dollar institutions. But one thing they all have in common is that competitive spirit and a belief that commercial real estate markets have hit bottom.

"The volume in investor interest and activity is way up," says Gary Hunter, CCIM, a managing broker and commercial investment specialist at Colliers International in Seattle. Over the past year, Hunter has closed several transactions totaling about $3.3 million. "At this point, demand for all asset classes is beginning to pick up with multifamily, small retail, and industrial buildings seeing the most activity in our market," Hunter says.

Clearly, the desire — and the money — to get deals done exist. Investors who have been sitting on cash waiting for market fundamentals to stabilize are now getting ready to pull the trigger on acquisitions. Debt markets also are beginning to loosen with more capital available, especially for properties in strong locations that are well-leased to credit tenants.

Following a record-low year for sales transactions in 2009, commercial real estate sales volume rose in 2010 and many industry experts expect that momentum to continue in 2011. The volume of commercial real estate sales reached more than $120 billion in 2010. Although that is a marked improvement over the $54.5 billion in property that changed hands in 2009, it is still well off the record $514 billion in sales that occurred at the market peak in 2007, according to data from New York-based Real Capital Analytics. The research firm tracks office, industrial, retail, apartment, and hotel sales valued above $5 million.

Market Drivers

So what are some of the dynamics driving today's investors? Overall, institutional buyers such as real estate investment trusts and life insurance companies are aggressively shopping major metros such as Washington, D.C., New York, and San Francisco for core properties in all segments of the market — apartments, retail, office, industrial, and hotels. Competition and pent-up demand for quality properties is pushing those buyers further out into secondary markets such as Minneapolis, Denver, and San Jose, Calif. Smaller private buyers, especially those with access to capital and local expertise, are finding solid investment opportunities outside of major metros in secondary and tertiary markets. Those private entities are pursuing a variety of strategies ranging from conservative triple net lease properties in Florida to opportunistic land acquisitions in busted residential subdivisions in Alabama.

Investors today are generally chasing properties in one of two categories: the relative "safety" of quality — well-leased properties in top markets — or the higher yields of opportunistic or distressed real estate assets. Core properties remain the favorite investment type.

"Throughout the entire year of 2010 there has been a tremendous flight to quality, whether it is retail, office, apartments or what have you," says Craig Thomas, CCIM, a senior associate and associate director of the National Retail Group at Marcus & Millichap in Jacksonville, Fla. That demand reflects the caution that is still rampant in the marketplace today, and the recognition that both the economy and commercial real estate markets are still facing a long, slow recovery.

BROKERS PURSUE NEW INVESTORS

Brokers are pulling out all the stops to both retain and attract clients in a market where sales are still just a fraction of the peak levels that the industry experienced in 2006 and 2007.

One of the keys to landing new business today is understanding that — while investor appetites for real estate are returning — buyers are proceeding very cautiously in the volatile economic climate. "The investor is more analytical and careful, and I think the investor is looking to find a broker that is much more informed and knowledgeable about the market," says Gary Hunter, CCIM, a managing broker and commercial investment specialist at Colliers International in Seattle.

Today's buyers are looking for more insight, expertise, and market knowledge from their brokers. In addition, clients want more from their brokers than just information on the acquisition. They also want more guidance on managing and operating the property, potential exit strategies, and even advice on financing properties.

"We have found it is crucial to be able to guide potential buyers toward the right type of loan and service provider who best fits the buyer and specific property that is being targeted," agrees Andy Burnett, CCIM, a senior adviser at Sperry Van Ness/William T. Strange & Associates in Oklahoma City. "A continual feed of market data regarding changes in operating fundamentals and legal regulation affecting financing are a must when it comes to engaging and working on behalf of new investors." The firm also has made a point to form strong relationships with key lending sources such as Fannie Mae and Freddie Mac.

Ronald Jury, CCIM, president of Jury & Associates in Shawnee Mission, Kan., is working with new investors in the market today, as well as looking for investments for his own account. His philosophy is to never sell anything that he wouldn't want to own himself. For example, Jury currently is pursuing a public/private partnership with the city of Kansas City to develop a 1,000-room convention hotel downtown. The investment is appealing because the partnership with the city helps to minimize risk, while developing in a down market lowers construction costs.

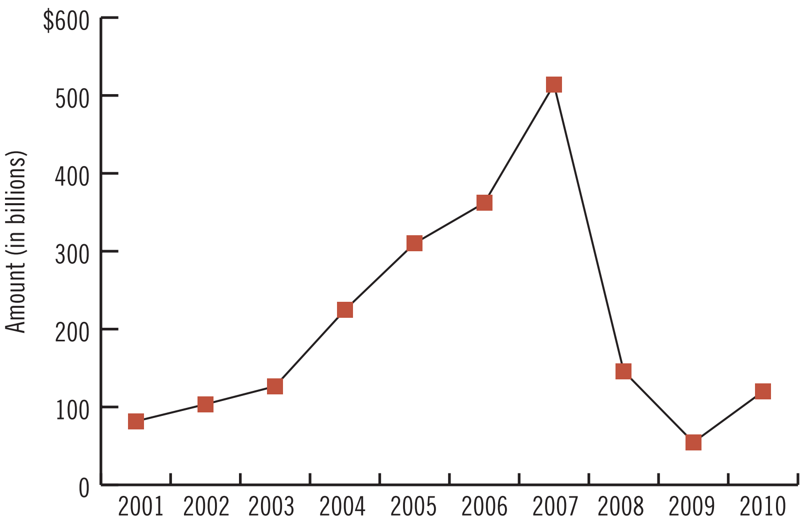
"I am not in real estate for the payday by moving a property for a commission. It is all about relationships," Jury says. "If you sell something to someone and it fails, they tell 10 of their friends and no one will call you in the future. If you sell something to someone and they succeed and you remain in contact with them, they tell 100 of their friends and you have more calls than you can handle."

Top Investment Picks

Multifamily is the property of choice among buyers due to improving fundamentals and a positive outlook for strong renter demand. Apartment vacancies dropped from 8.0 percent in 2009 to 6.6 percent in fourth quarter 2010, while effective rents rose 2.3 percent

U.S. PROPERTY SALES

by dollar volume



Source: Real Capital Analytics

in 2010, according to New York-based Reis. “The primary reasons for the strong interest in multifamily properties are the availability of financing and a growing supply of renters due to the echo boomers, aged 20 to 34, moving out of their parent’s house and into apartments,” says Andy Burnett, CCIM, a senior adviser at Sperry Van Ness/William T. Strange & Associates in Oklahoma City.

Government service entities such as Fannie Mae and Freddie Mac have continued to finance multifamily transactions over the past three years, which has helped to fuel sales transactions within that sector. For example, Sperry Van Ness/William T. Strange & Associates brokered the two largest multifamily transactions in the state of Oklahoma during 2010 with the $17.2 million sale of Regency Tower and the $19.7 million sale of Stoneleigh at May apartments. Both Oklahoma City transactions were funded through Freddie Mac.

In fact, demand for apartments is so strong that it is spurring buying activity across the spectrum of class A, B, and C properties in primary, secondary, and tertiary markets. That competition has put pressure on pricing. Capitalization rates for top quality mid- and high-rise apartments dropped 75 basis points in 2010 to average 5.5 percent in 3Q10 and remained unchanged in 4Q10, according to Real Capital Analytics.

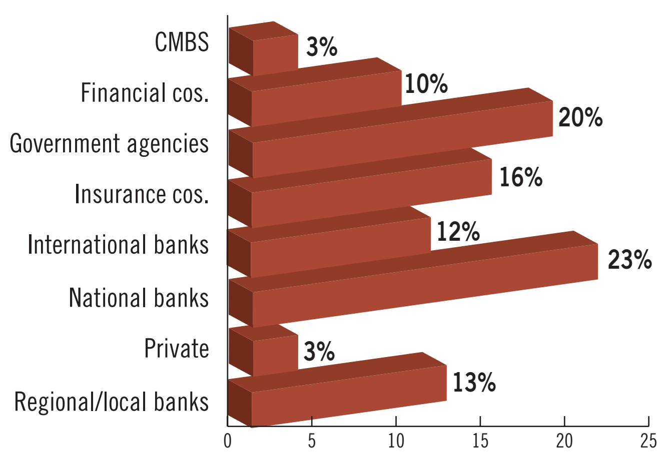
“Apartments are always on the radar but are overpriced today,” says Ronald D. Jury, CCIM, president of Jury & Associates in Shawnee Mission, Kan. As a result, some investors — particularly those with access to capital and the ability to hold an asset long-term as the market recovers — are finding good value-added opportunities in other sectors. For example, it is a buyer’s market as it relates to office buildings that are either in foreclosure situations or are struggling with high vacancies. “With today’s unemployment, you have to have a strong investor who is willing to buy those because it is going to take five to seven years to get any type of occupancy back in those buildings,” Jury says.

Last fall, Jury assisted an owner-user in acquiring a 225,000-square-foot, class A office building in downtown Kansas City that included a covered parking garage for 565 cars. The property sold for just under $12 million, which is less than it cost to build the entire parking garage. “It is not often that you have an opportunity to buy a parking garage at cost and get a class A building thrown in for free as a part of the transaction,” Jury says. “It will be a long time before we see pricing like this again.”

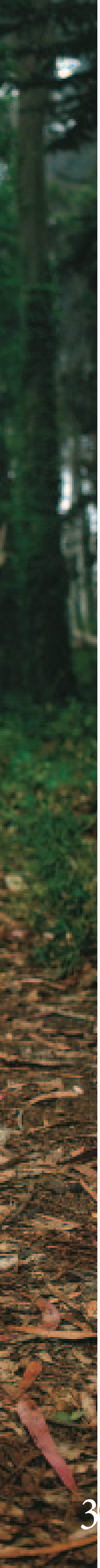
Investors and lenders alike also are demonstrating a stronger appetite for single-tenant net-lease properties. Marcus & Millichap

WHO IS LENDING?

2010 loan origination by volume



Source: Real Capital Analytics



closed 950 retail transactions nationwide during the first 11 months of 2010. Those transactions were valued at $2.23 billion, which represents a 10 percent increase compared to 2009. The majority of those retail sales, about 65 percent, involved single-tenant net-leased properties priced between $1 million and $20 million.

"There is a lot of risk aversion that still exists in the market," Thomas notes. Triple-net acquisitions are very attractive for the asset preservation and steady cash flow of long-term leases with corporate credit tenants such as Walgreen's or McDonald's, he adds. The surge in demand for net-leased properties is driving prices higher, especially among top credit tenants. For example, Thomas recently brokered a ground lease on a McDonald's in north Florida that went for a 5.5 percent cap rate.

Searching for Bargains

Although there has been an expectation that there will be a significant number of distressed properties hitting the for-sale market, those bargains have been slow to materialize. Lenders have been reluctant to foreclose and instead are willing to do loan workouts and extensions wherever possible in order to keep the distressed assets off their books. However, some of those deals will continue to hit the market in 2011.

"Banks are ready to start moving these commercial properties that they may have taken back in foreclosure almost a year ago in some cases," Hunter says. For example, Hunter is listing a vacant restaurant property in Seattle for Wells Fargo. The property reverted to the bank after the restaurant operator filed for bankruptcy. Most of the offers on that property have been well below market. The current offer for the 5,280-sf property is about two-thirds of the $1.2 million appraised value. The bidder is a religious organization that would like to convert the restaurant to a church.

Investors also are chasing bargains in discounted land plays. Spanish Fort, Ala.-based Bellator Real Estate and Development represents several investment groups that are making discounted purchases of developed lots, partially developed subdivisions, and raw land. "Once we acquire these subdivisions, the focus is on facilitating activity within them, whether that is raising money to loan back to home builders or promoting the subdivision to generate pre-sale houses," says Nathan Cox, CCIM, Bellator owner and president.

Bellator currently manages about 20 separate investment groups that vary in size from several hundred thousand dollars to a few million dollars. So far, the investment groups have committed about $10 million to land acquisitions throughout Baldwin County, Ala. "There is a lot of interest from investors who don't want to miss the boat," Cox says. Bellator has been able to acquire lots at between 20 cents and 40 cents on the dollar compared with what they sold for at the peak of the market. For example, the firm has bought some lots at $12,000 that were selling for $130,000 in 2007, while others have been priced at $20,000 compared to sale prices of $80,000 a few years ago.

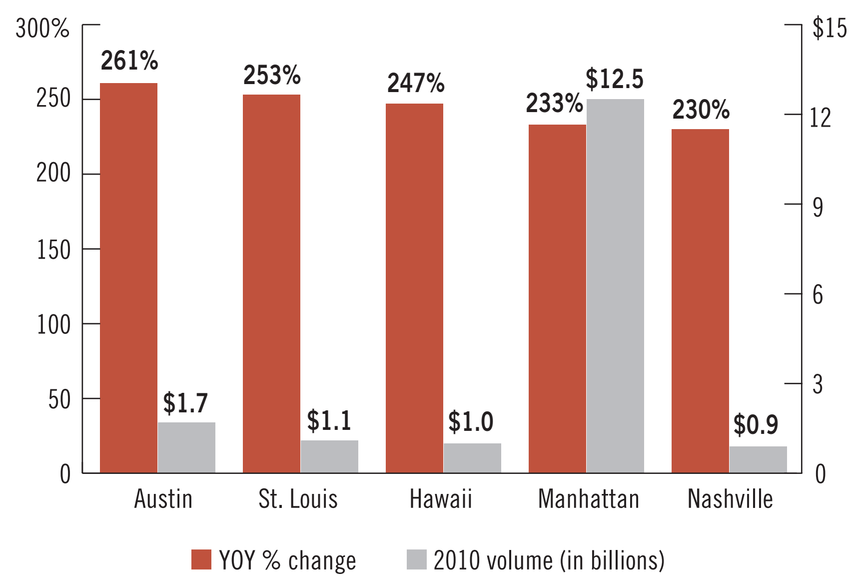
"We have seen a big shift in the last few months by banks trying to get this stuff off their books, so we have been real active trying to acquire property," Cox says. Bellator anticipates a very busy year in 2011 with some of the bulk residential land deals starting to slow down in 2012. The firm is targeting opportunities within Baldwin County — specifically the eastern shore in communities such as Spanish Fort, Daphne, and Fairhope — which experienced a big boom and bust in its housing market.

Although distressed sales are still scarce, many industry observers are hoping that the resurgence of investor demand and thaw in debt markets will help to bring more for-sale properties to the market in the coming year. "As a whole, whether it's investors, developers, retailers, tenants, or brokers, folks know they are going to have to work longer and harder on each individual deal to get them across the goal line," Thomas says. "But that is happening, and overall, I think the outlook is very positive for 2011 and 2012."

Beth Mattson-Teig is a freelance writer based in Minneapolis.

WHERE THE ACTION IS

Markets where commercial real estate dollar volume doubled in 2010



Source: Real Capital Analytics