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## Uncertainty Weighs Heavily Over Fourth Quarter Outlook

*Momentum Shifting, but Unease Over Near-Term Market Prospects and Light Deal Volume Causing Hand-Wringing by Investors, Lenders and Tenants*

Typically by October, the commercial real estate industry can see its way clearly through the end of the year, with a pretty good idea of what can be accomplished and how the rest of the year will play out. But these are not usual times. The loads of uncertainty and constantly shifting market conditions that characterize this fourth quarter are making it very difficult to muster any certainty over what the coming months will bring.

Just a few weeks ago, the markets were abuzz with the specter of a double-dip recession. But those worries have largely subsided and replaced by signs that the capital markets may finally be loosening up. Then there are the upcoming politically charged elections and the prospects of a shift in the regulatory and legislative environments.

Want more uncertainty? Consider that buyers and sellers still can't seem to narrow the gap in their pricing expectations. Couple that with banks and loan servicers collectively having no clear strategy for dealing with problem assets and pending maturities, and what you get is much indecision on the part of investors, lenders and tenants resulting in a lot of hand-wringing over both the near-term and long-term by CRE folk.

We queried a random sample of CoStar Group news readers about their outlooks and goals through the end of the year, asking what do they see that is standing in the way of accomplishing those goals, or, conversely, helping to achieve them.

While their answers range from the extremes of depressing to upbeat, in general, there seems to be a sense that the markets continue to have momentum away from the past two years, but there is still very little deal flow or jobs to support that momentum.

In addition, there may not be deal-flow going forward to support it either. Banks and loan servicers have been pushing their "problem loans" further out into the future and are only now getting around to taking them through the foreclosure process.

Meanwhile, there is an "astonishing, almost stupid" amount of money sitting around waiting to pick up deals. But sellers don't want to put bargain prices on their properties, according to one real estate consultant.

And as one broker told us: "it is the toughest market I have ever seen in 30 years. I've just in the last few days given up on all of my goals of completing any new transactions this quarter. (Instead,) I'm going to exercise a great deal more, concentrate on getting off of the computer, away from the cable news, and lower my stress. I'll get back to real estate brokerage in January when at least some of the dust of the political world will have settled some."

The comments we heard and received - and presented here - paint a very personal picture of the fourth quarter 2010 market uncertainties and hopes from those who are actively engaged in the market right now.

Early Stage of the Next Upturn

Tim Wang, Senior Vice President Research & Investment Strategy, ING Clarion, New York

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ING Clarion believes that we are in the early stage of the next upturn cycle. Many people will likely be surprised by the strength of rebound in commercial real estate fundamentals and pricing. The global search for yield is already putting rapid downward pressure on the cap rates of institutional quality properties. It is possible that the total return of NCREIF Property Index for 2010 could exceed 10% for the year.

Despite the slow and uneven progress in the general economy, real estate capital markets have improved remarkably over the past year. Lenders, especially life insurers and foreign banks, have re-entered the commercial mortgage market, with increasing competition between lenders leading to lower mortgage rates and higher loan-to-value ratios for high quality assets.

While risks remain, including ongoing business and consumer deleveraging, rising distress, and weak fundamentals, investors are beginning to recognize the intrinsic value of real estate assets and adjust their market outlook accordingly.

#### Even Long-Negotiated Deals Can Be Rejected Out of the Blue

Andrew R. Little, Principal, John B. Levy & Co., Richmond, VA

The fourth quarter is a time to push for closings that can increase the bonus pool. This year, we are working hard to get several deals closed by year end and, in my best guess, 2010 production will surpass last year, which surpassed 2008. However, the market still does not feel healthy.

Very few small- and mid-sized banks are able to put new money out and the big banks seem able, but entirely focused on the "bald-headed deal" (no hair). Life companies are also finding their footing and are more willing to stretch on dollars today versus the last 24 to 30 months. They are aggressively pricing solid deals in good markets and those life companies that are seeking yield are pushing LTV a little or going to secondary or tertiary markets.

While the market is getting more accustomed to the new levels of leverage and underwriting, the one area of business that continues to confound us is dealing with special servicers. We see absolutely no motivation to do anything at the special servicer level. A long negotiated deal with a special servicer (that seems fair to everyone involved) can meet rejection with no counter offer as soon as it is taken to "the guy down the hall that signs off on everything." Then you wait for another three months before anything more happens. Meanwhile, the property deteriorates, tenants go away, the sponsor's capital gets directed to another deal, etc.

#### Seller Expectations at Inflated Levels

Jason S. Perlroth, Principal, Grand Run Capital LLC, New York

While I never wish for things to sour, a general uptick may expand seller expectations beyond the already inflated levels. In general, the pricing spread between sellers and the market is still too wide, so coupled with a general uptick, the risk/reward profile may further deteriorate.

I'm cautiously optimistic for the fourth quarter. I believe that things will continue to trend positively, but we can expect a seasonality effect and possible negative implications from government forces.

Heading into the final quarter of 2010, my main goal is to close no less than one of the acquisitions currently under consideration and in negotiation. Outside of this, I'm hoping for deal flow to continue to increase, or at least certainly not decrease.

#### Expected Loan Loss Levels Coming Down

Malay Bansal, Managing Director, NewOak Capital LLC, New York

Regulators have tried to avoid forcing fire sales by giving banks and other institutions more flexibility to extend or modify loans. Their actions have been criticized by many as extend-and-pretend or delay-and-pray, but reality is that forced selling would have depressed prices even more. But if prices are bottoming out, giving more time to borrowers will reduce losses on loans. Expected loss levels have indeed come down for most people in last few months.

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Problems in commercial real estate are not over. The volume of maturing CMBS and other CRE loans ramps up in 2011 and 2012. There is a value gap that the borrowers will have to deal with once loans mature or are at the end of extension. Borrowers will have to put in additional capital, find partners, or lose the property. Next year, we will see more of these instances.

For CMBS investors, deal analysis will become more complicated. Deals with high delinquencies may be left with better collateral after weaker loans have defaulted than deals where weaker loans are yet to default. Careful loan-by-loan analysis will be necessary.

Multifamily sector will continue to do relatively better. Hospitality has suffered and is seeing a lot of interest from investors on good properties. Office sector will feel more pain as leases mature.

### **Extraordinarily Active for Non-Performing Loan Sales**

Kenneth A. Cohen, Chairman and CEO, TMAC, San Francisco

We anticipate that the fourth quarter will be extraordinarily active for non-performing loan sales. In some ways, we see this market at similar to the residential home sales market. Only those sellers who conclude that they absolutely do not want to continue working the same number of non-performing loans in 2010 (and therefore accept the pricing levels of buyers who can perform) will be likely to complete transactions. We look to complete several large portfolio acquisitions as well as one off sales.

### **A Willingness To Do Land Deals Again**

Richard C. MacDonough Jr., Vice President, The J Street Cos., Washington, DC

The market is better. With some predictability in home pricing having returned in a number of areas, financing arrangements for development are available. The spigots aren't open full bore, and they shouldn't be. Nevertheless, a lot of my clients are willing to underwrite, offer and close on deals again. That is particularly the case with multifamily deals and development sites in areas with solid schools and high barriers to entry. BRAC's importance cannot be understated in terms of the Maryland suburban markets, in particular.

Our goals in the fourth quarter are to generate 10 solid deal leads per month with each having a seven-figure minimum value, then getting at least one per month into substantive contract negotiations.

Consequently, our land sales team has begun an energetic expansion into all suburban markets in Maryland and Northern Virginia. We also are in the process of hiring highly experienced professionals, and we have committed to doubling our land sales opportunities and downstream relevant leasing engagements.

### **Waiting on the Housing Market**

John L. Morrissey, Senior Commercial Associate, MGR Real Estate, Upland, CA

I think [the fourth quarter] looks better but not good by any means. Homebuilders want to build but construction financing is hard to find at best. Investors have cash on the sidelines but want unreasonably low prices to make a purchase. SBA owner occupied deals are getting done. I don't see things getting better until we get new housing going, which is where we get our jobs back. Then everything else will come back.

### **Every Single Deal Has Something Somebody Doesn't Like**

Marty Busekrus, Senior Associate - Investment Sales, NAI Rauch Weaver Norfleet Kurtz & Co., Fort Lauderdale, FL

Goals for the end of the year are just survival in the investment sales brokerage business. Every single deal has something about it that buyers and their borrowers don't like. The trophy assets are moving again, but on the deals under \$20 million and into the class B/C category there is almost no movement.

From the brokerage standpoint it's a dangerous game because you have to hitch your wagon to the right horse if you want to win any deals. I've found there's still dumb money out there paying prices that just seem too high for 99% of the buyers I deal with.

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What's helping is that at least transaction volume is increasing. It's not great, but there have at least been a few deals that we can work comps off of.

### **Slow but Very Mediocre Improvement in Multifamily**

Neil K. Sethi, Executive Vice President, Landis Properties, Worthington, OH

We are just starting to see some recovery these past few months with our [multifamily] occupancies, etc. So hopefully we will be able to get some traction on increasing our revenues to bring our budgets into balance. It is still a tough environment. As of now the fourth quarter is looking pretty decent at our B-Class properties in more favorable areas, but our B-Class property in a less favorable area continues to struggle.

### **Timing, Timing, Timing**

Adelaide Polsinelli, Associate Vice President Investments, Marcus & Millichap, New York

They used to say that the three main rules of investing in real estate were: location location location. Today it's more like: timing timing timing. You can buy the best location but if you bought it at the wrong time, you can be left with a mess - just ask the big name game players of the past three years.

I have been working harder than I can remember in my entire 26 years in this business. I am happy to say that I am reaping the rewards and closing many of the deals I have been working on. I would be satisfied if all the deals I have in contract close with minimal problems. I currently have over \$100 million in expected closings this year.

Any additional game-changing regulations, or unexpected tragedies, could upset the market and cause lenders, and investors to re-evaluate. Market conditions have forced me to be more disciplined and patient.

### **Focus on What Is Selling**

Joel Owens, Broker, All World Realty, Canton, GA

This year has been great for the Atlanta, GA investor market. Our main emphasis has been on distress and income producing properties. Land is not moving unless it is selling for a liquidation value. Many feel apartments will recover first and that is where most purchase activity is happening. Retail in our markets has a long way to go to recover.

Investors are active in the market and buying up deals where before the bid-ask gap was too broad.

I have met my goals and 2011 will be the best yet. You have to focus on what is selling in the market and go over those properties for listings or purchases with your buyers.

### **The Robin Hood Threat**

Steve Tutt, Commercial Realtor, KW Commercial, Fremont, CA

Market activity for the rest of the year rests largely on the outcome of the election,

The confidence of the investors I am working with and the direction they take depends in great part on the election and the creation of sustainable recovery. We won't see sustainable recovery until unemployment numbers show substantial change. We won't see this until economic policy changes direction and the Robin Hood threat is eliminated.

I am exceeding my goals for the year, but then anything is better than nothing. I have learned that a market always exists and one's success in the market of the moment depends upon one's ability to adapt and to make one's clientele aware of current market conditions and opportunities, as well as the short- and long-term prognosis.

I started the year looking for long-term opportunities for my clients. During the second and especially third quarters, some focus has been transferred to short-term opportunities. Going into the third quarter I have abandoned, at least temporarily, short-term objectives, waiting on the outcome of the election to dictate direction.

#### Positioning for 2011

Charles Swope, Broker of Record & Chairman, Swope Lees Commercial Real Estate, Westchester, PA  
We have a good pipeline going into the fourth quarter - some of that activity will translate into deals in the first quarter of 2011. Our goals for end of the year are to position for 2011.

#### To Paraphrase Rockefeller...

Alex J. Beachum, Income Property Organization, Bloomfield Hills, MI

Like almost everybody else, our firm has been forced to continually adapt and refine our business model since the downturn really solidified after Lehman tanked in the fourth quarter of 2008. It has been a constant process of assessing and reassessing trends in the disposition of distressed assets, and learning to identify the various protocols and strategies lenders-from portfolio lenders, to CMBS special servicers, to GSE's- will utilize when attempting to resolve a default.

To paraphrase Rockefeller, "family fortunes are made in depressions", and implicit in that statement is the acknowledgement that any significant downturn affords savvy investors and businesses ample opportunity to capitalize. Which is precisely what our firm has aspired to do and the results have become more encouraging as each quarter passes.

#### Financing for Deals Loosening

David Schoenemann, Broker, CRES Inc., Austin, TX

I think the year will end up somewhat gray, not dark or bright light, but gray. I say this because I think the lenders here in my trade area have started to loosen up and are at least talking about and structuring deals that make sense. This is a change from the first quarter were they weren't even talking.

I have three deals that were scheduled to close in the third quarter, they required financing to move forward. I have one deal closed and the other deals real close and will close in the fourth quarter. They have been a result of the loosening of financing for commercial deals. All of the financing has been done with local banks that know the landscape here in Austin, Texas.

#### Some Promising Signs in Central Florida

Nicholas E. Ledvora, Managing Director, Equity Investment Services, Orlando, FL

2010 has been a rollercoaster for commercial real estate in general. Our leasing and management team has grown. There has been a need to find aggressive brokers to fill holes and stabilize assets. Rents in the Central Florida market have fallen anywhere from 20-40% based on class of asset and specific market. It looks like vacancy has stabilized at plus or minus 12% based on our research.

Our fourth quarter looks very strong. We have a dedicated real property tax appeal team that filed approximately 500 appeals across Florida and sales are finally picking up. Banks are pretty close to "marking to market" and deal flow looks promising.

We expect to close 25 to 30 leases in the fourth quarter. Based on our activity reviews and past performance this looks good. Landlords are also realizing that they need tenants and income to "float" debt and cash flow. They are realizing that this recession is going to be a longer dip than originally expected.

#### Leasing Returning; Acquisitions To Return 2011-'14

Aasif M. Bade, President, Ambrose Property Group, Indianapolis, IN

The fourth quarter of 2010 will see increased sale activity prompted by tax change worries and a tiny easing of credit. Banks have clearly increased their interest in dumping REO assets and we only expect that to become more prevalent during the fourth quarter.

Leasing activity seems at the strongest of the year, and most of this activity will result in completed first and second quarter 2011 deals.

We've become more focused on 2011-2014 acquisitions vs. 2010 acquisitions. The market remains

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unstable, assets are priced too high, and for trophy deals, there is 2003-2005 "stupid money" circling. Foreign investors are troubled by the substantial bad news that poured out during the early part of third quarter 2010, and seem much less sensitive to the good news that has been hearty during the last 30 days.

#### More Assets Coming to Market in Denver

Richard Egitto, Senior Managing Director, Crimson Services LLC, Littleton, CO

Leasing activity has been strong this year compared to last year (not much to compare it to I realize) but nonetheless it has been consistent throughout the year in Class A office space here in Denver.

Clearly from an investment sales point of view, the market is seeing more assets come to market as we move to the fourth quarter and financing is easing for better quality, better located product (it is still not readily available, but it is easing). Early this year it seemed the only assets that were trading were core properties in core (Top 5) U.S. office markets and a foreclosure or two here and there.

As we moved into the second and third quarters it has become clear that the pent up money on the sidelines is now looking at a wider range of assets and for lower returns, and the banks are now starting to proactively foreclose on assets -- thus I believe we will see greater deal flow as we move into 2011.

#### Greater Fool Theory Back in Play?

Jim Gulley, Principal, James Gulley Ltd., Baltimore, MD

The one trend that seems to be coming back is the "value-add" play. A bellwether here in Baltimore will be the Loch Raven Village deal. Foreclosed upon a month ago by The Principal Financial Group, this 500-unit plus, Class C (60 years old), asset traded in 2006 for \$32 million plus. Principal bought it at auction for \$18.6 million. I produced one of three offers in the \$18.6 million to \$20 million range, which Principal rejected. It is now being marketed as a "value-add" play. What's interesting is that the buyer in 2006 bought it as a value-add deal and was unable to create any value. So whether the Greater Fool theory is back in play remains to be seen.

#### Tenants Kicking the Tires in Atlanta

Leigh C. Bower, Vice President, NAI Brannen Goddard, Atlanta

The last quarter of the year may pick up slightly because companies with leases expiring in early 2011 will be focused on making their decisions before year-end so they can adequately budget for next year. Oftentimes these tenants will be "kicking the tires" to compare their current landlords' offer on a renewal against a relocation. And then there are those tenants wanting to "upgrade their image" via taking advantage of the "tenants' market" and move to a nicer building.

The entire 2010-year has been an extremely slow one. My goals were set low for this year to adjust to the low demand and struggling economy.

In landlord representation, market conditions have indeed prompted changes or adjustments of objectives throughout the year and will be on going based on the numbers of owners of commercial real estate with assets in distress. With few exceptions, owners of real estate are in dire need of complete focus on their assets in order to meet debt obligations, stabilize their assets, adequately compete, retain tenants or otherwise raise occupancy levels to generate rental revenue.

#### Continued Downward Pressure

Fred Harllee, Review Appraiser for Special Servicer, Ponte Vedra, FL

For the fourth quarter I see continued downward price pressure in any properties other than Class As. Class C and D apartments continued on a downward trend with the Midwestern states being hit hard by the troubles in the auto sector. There are buyers now entering the market aggressively wanting high equity dividend rates and loans becoming more available at historic high DCRs.

#### Growth Is Elusive

Blanche Horst, Jones Lang LaSalle Americas Inc., GSA National Broker Contract, Washington, DC

There seems to be a run of large government deals that is sustaining a decent leasing market in

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downtown Washington, DC and other metro areas. However, the deficit and runaway spending ultimately will trigger re-evaluation and belt-tightening.

Market conditions prompted conservative 2010 targets this time last year. Targets have been raised modestly but remain achievable. While the market has been resilient in DC despite national trend, recovery and growth are elusive. Cautious optimism will continue for at least three to five years. Bailouts and stimulus spending are a hindrance to meaningful vibrancy, but opportunities exist.

I will meet my goals by sheer grit.

### Reality Check in Effect

Rachel K Maman, Consulting Broker, Hera Development Corp., Brighton, MA

Things look better than this time last year overall. The reality check is officially in effect.

Market conditions have changed our perspective. Once reality set in (global devaluation) we exercised more caution than 12 months ago. We understand this is a high-risk, high-reward environment that requires enormous restraint, conservatism, and due diligence to prevail.

It is a counter intuitive environment, like short trading. You want to get in there and day trade like there is no tomorrow. Instead you rein it in, watch what the big boys are doing, do some shadow trading and read everything from the Wall Street Journal to the Orlando Business Journal to the Ladies Home Journal :)

### Widening the Field of Play in the Southeast

Mac McCall, Senior Director, Franklin Street Real Estate Services, Atlanta

The fourth quarter and into 2011 will continue to present challenges and we see a tremendous growth opportunity because property owners want to work with brokers who will partner with them and help them tackle issues with creative solutions.

Our objective is to remain extremely active and continue to meet with new clients who own assets across the Southeast. We have been in an expansion mode in 2010 and have opened offices in Atlanta, Jacksonville and Fort Lauderdale with experts in investment sales, leasing, management, finance and insurance who are working together to help clients maximize their investment returns.

### Enormous Amounts of Cash - and Hesitancy To Spend

Paul Katz, Principal, Nexxus Advisors LLC, Chicago

As is well known, there are still enormous reserves of cash sitting on the sidelines and still hesitancy to invest as many buyers are not sure "the time is right." We have seen no widespread urgency to invest now, as many feel that prices may continue to drop or, worst case level out, as loans come due at an increasing rate and lenders try to resolve their REO and troubled loans-so no urgency to invest now.

On the other hand, idle cash is earning next to nothing and we believe we'll see those opportunistic investors who are not concerned about timing the absolute market bottom and have substantial cash, continue to buy. Unfortunately, there are certainly not enough of them to lift the markets nationally, but we are seeing more transactions completed than last year.

### Underlying Fundamentals Not Encouraging in California

Joseph Gabbai, Senior Vice President, Grubb & Ellis Co., Los Angeles

I believe that after a bit of tightening at the beginning of the year (which could have been caused by the government stimulus package), the market has slowed down through the third quarter, with the slowdown continuing through the end of the year.

I further believe that until and unless the local economy starts creating jobs in substantial numbers and on a sustained basis, the underlying fundamentals will not improve in any appreciable manner.

Another point that usually gets overlooked is the "shadow space" that exists in the market (surplus space

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that for some internal reason is not being marketed for sublease). By some accounts, the size of this category of space could be as large as the sublease space. Therefore, even when the economy starts creating jobs thereby creating demand for space, this shadow space will get absorbed first before the market will get to absorb the available sublease and direct spaces, thereby postponing the time landlords may realistically expect to be able to raise rents.

The goals are keeping the lease deal flow going with any eye towards owner/user sales if possible.

#### Fear Has Taken Over Student Housing Sector

Chuck Paxton, Carolina Homes & Land Realty, Harrisburg, NC

For me, market conditions appear to have changed. I am in a niche market of student housing development. The first part of the year my business was booming. Today it appears fear has taken over this industry. Developers, those that are left, look in the fourth quarter and buy in the first quarter of the new year. The deals must be superior to even get them to take a second look.

Everybody is looking for distressed properties, however, these possible buyers are not being realistic. Today possible sellers are holding out waiting for a turnaround that may never happen. Buyers are waiting for the next price drop that may never occur. That leaves the real estate broker looking but never able to seal the deal. Determining a good deal has never been harder, due to this attitude.

#### Money Restless, But Not Reckless

Jag Grewal, Commercial Realtor, Ian Black Real Estate, Sarasota, FL

In general, our outlook for the remainder of the year is one of caution. It seems like the buyers that we have are holding off from making a decision until after the election. One of the main indicators of this trend, to me, is that Walgreens and other blue chip NNN assets have been sold off, to the point that cap rates on that asset class have been trending to almost below 7. That would indicate investors believe that we are going to be in a holding pattern for some time and they better find a spot top park the cash than a CD. The money on the sidelines seems to be restless but not reckless!

I can't tell you how many emails I have received from brokers with buyers looking for WAG's or any decent NNN investments. I can't seem to find a WAG for around 7.2 cap to save my life!

#### Finish Strong

Nicholas L. Miner, Vice President - Investments, Commercial Properties Inc., Scottsdale, AZ

My goals are to finish the year strong. I had the opportunity of closing 2 sale deals at the end of the 3rd quarter and I am currently working on a couple more that would try to close by year-end. The biggest hurdle is still financing. Cash is king, but cash is also very patient.

I believe that more transactions are going to occur in the second half of 2010 than all of 2009 and first half of 2010. I am starting to see larger transaction trading at very affordable prices. Recently, a larger grocery-anchored center that I had in escrow two different times with the last time being in escrow at \$75/SF just closed to with the owner of the center on the adjacent corner purchasing it for cash at \$48/SF.

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