

Developer

The Business of Creating Successful Sustainable Communities

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The Fallout

The commercial sector struggles to stay afloat.

By Margot Carmichael Lester

Struggling residential developers aren't alone. Commercial real estate is facing its worst year since the 1991/1992 depression, concludes the *Emerging Trends in Real Estate 2009* report, released by the Urban Land Institute and PricewaterhouseCoopers.

The report projects losses of 15 percent to 20 percent in real estate values from the mid-2007 peak. "The cyclical real estate markets always come back, and they will this time, too, but not anytime soon," says Tim Conlon, partner and U.S. real estate sector leader for PricewaterhouseCoopers. "Commercial real estate was the last to leave the party, will feel the pain in 2009, and may be the last to recover."

The second-quarter Society of Industrial and Office Realtors Commercial Real Estate Index echoes the *Emerging Trends* report. The index rating, which measures 10 variables pertinent to the performance of U.S. industrial and office markets, declined for the sixth consecutive quarter to an overall total of 76.4. That's well below the 100-point level indicating a balanced marketplace.

"Situations tend to be more dramatic

and dynamic on the way down versus a bull market, so executing [more deals] becomes more challenging," says Jason Clauch, senior vice president for retail at Dallas-based land development firm Billingsley Co.

Industry experts expect financial and real estate markets to bottom in 2009 and then flounder for much of 2010. So exactly how can commercial developers deal with such a downturn? Here are three ways to get through the tough months to come.

LEAD THE MARKET

Developers can get ahead by staying ahead. "Do whatever it takes to lease the space," says Craig Meyer, Los Angeles-based national practice leader for industrial with Jones Lang LaSalle, an international real estate brokerage firm. Some landlords are undertaking direct outreach to tenant-brokers, in addition to offering incentives such as huge tenant improvement allowances, months of free rent, or fixed common-area maintenance costs.

"Capturing occupancy is the name of the game," he asserts. "Most markets will see flat to slightly negative absorption rates over the year. In previous recessions, those

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Next to Fall: The commercial sector will struggle in 2009 without some prep work.

who were quick to respond and 'take their medicine' early benefited the most."

BE IN THE KNOW

It's critical to keep an eye on economic indicators, says Chris Muller, head of marketing for Current Building, a contractor based in Pompano Beach, Fla. "We learned this the hard way—the direct result of seeing 85 percent of our condo work decline to zero in only two years."

To stay ahead of the curve in the future, the firm plans to conduct better research. "One way we have already begun doing this is [via] specialized work, such as parking garages and industrial warehouses that are not as significantly affected by the current economy," Muller says.

INVESTIGATE ALTERNATIVES

With debt and equity increasingly difficult to place, alternatives are the way to go. "A year ago, owners and developers could reach out to their existing relationships with a strong certainty they would find and close a transaction," says Walter Conn, president and CEO of Los Angeles-based Figueroa Capital, which connects developers to banking, insurance, and other sources of permanent lending.

Not anymore. "Developers are in a different borrowing climate now and must be flexible and open-minded to attract the capital they need," he adds. "[Do not] simply rely on the lowest rate provider. It's far more prudent to pay a little more for capital that will close on time and works with you at take out."