TODAY'S INVESTMENT AND DEVELOPMENT LANDSCAPE

by
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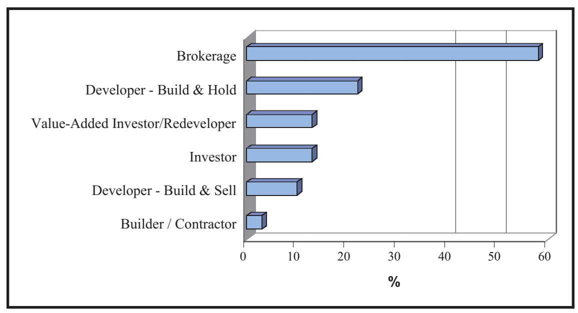
In April 2003, SIOR conducted an online "Zoomerang" survey of its 2,300 members—including its 110 developer associates—as well as 100 non-member developers and investors. The survey was intended to be a benchmark study to be conducted on an annual or bi-annual basis to track trends in the investment and development market, key issues and obstacles, and marketplace efficiencies.

The survey requested a profile of the respondent's company, investment criteria, and marketplace efficiencies and allowed the respondent to comment on issues and obstacles. Respondents provided insight into the viewpoints of Society members and other industry professionals. **Thomas E. McCormick III, SIOR,** Panattoni Development Company, Sacramento, California, and I moderated a Shop Talk panel at the 2003 Spring Convention in Maui, Hawaii during which we presented the results of the survey. We discussed the survey and took note of the audience's opinions and comments. The following summarizes both the survey and the comments/responses from the convention attendees.

Respondent Profiles

The first question asked was simple: Are you engaged in development and/or investment activities? If so, which of the following best describes your company?

The chart in the next column shows that 55 percent identified themselves primarily as brokers. While this result is expected from a broker-oriented organization, what is interesting is that so many of SIOR active members develop and invest on their own account. Of those that identified themselves as developers, the build-and-hold group outpaced the value-added respondents by a 2:1 margin and the build-and-sell sector by 2.5:1 ratio.

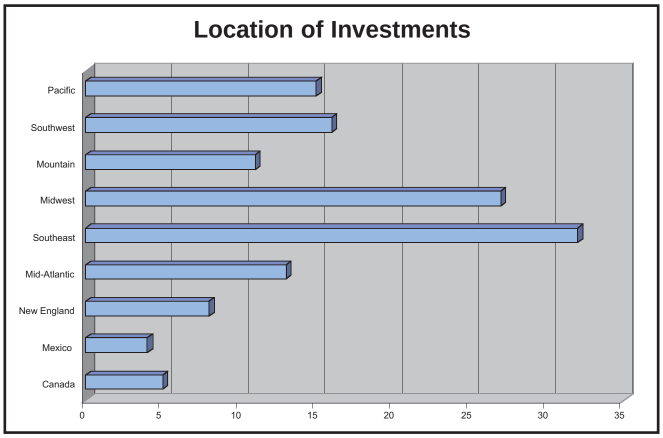


The respondents' overall portfolios have the following components:

➢ Industrial	633,826,000 SF
➢ Office	173,590,000 SF
➢ Retail	37,274,400 SF
➢ Hotel	920,000 SF
➢ Multi-Family	33,636 Units
➢ Residential	5,628 Units

The ratio of office to industrial (3:1) is in line with the national average. (SIOR's *Comparative Statistics* tracks 13.3 billion square feet of industrial to 4.1 billion square feet of office-space.) While not all developers/investors had assets in each class, it does display a well-diversified portfolio. From an SIOR programming perspective, it also indicates that our convention investment workshops should address other asset classes outside the industrial and office classifications.

The portfolio is also geographically diverse, with the clear leaders in the Southeast and Midwest. The location of the respondents did not necessarily coincide with the location of the assets. As an example, there were no respondents from Mexico but four percent indicated they had assets there.



Where We Belong—SIOR Rules

The final question covered in the profile section asked what professional organizations they (or their company) belong to and in which do they actively participate. While it was not surprising that 88 percent of the respondents said that they are SIOR members, the good news is SIOR had the largest margin of those that are both members and active participants. (Well, perhaps that is not so amazing, as anyone who spends the time to answer a survey is probably an active member.) McCormick said that Panattoni places SIOR as the #1 organization to do business in and with; it is the only group they budgeted to sponsor in this economy.

What is most interesting is where the respondents do not belong. Among the "Where the Money Is" groups, CMSA (the commercial mortgage-backed securitization trade association) had no members, NAREIT had only five (three non-active, two active), and MBA (Mortgage Bankers Association) had seven non-active and four active members. As a CMSA member, I attend their conventions. I find them to be a powerhouse of the banking/investment world with great networking. Even if you do not work directly in securitization, it is still a major force and there are many spin-off transactions occurring.

The "Where the Deals Are" trade groups fell in the middle. ICSC had 14 inactive plus 20 active members. **Herbert L. Krumsick, CCIM, CRE, SIOR,** J.P. Weigand & Sons, Wichita, Kansas, said that (after SIOR) he has gotten involved with ICSC even though he belongs to several other national groups. Thirty-three percent of the respondents are members of CoreNet Global, and they were evenly split between active and inactive. I have attended a CoreNet Global convention and found their networking to be superior to their educational programming. **P.K. (Phil) Nanavati, SIOR,** Martel Commercial Realty, Burlington, Ontario, Canada, commented that CoreNet Global's meetings are like MIPIM (France's International Real Estate Market) meetings. They are so large that you must go in with a game plan and set up meetings with key people in advance of the event. **Daniel F. Wilkinson, CRE, SIOR,** Colliers Wilkinson & Snowden, Memphis, Tennessee, said his company is active with the Council of Logistics Management (not on the survey) and they have found it to be worthwhile.

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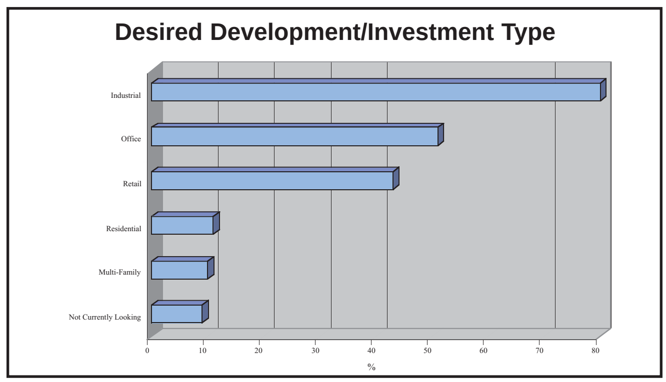
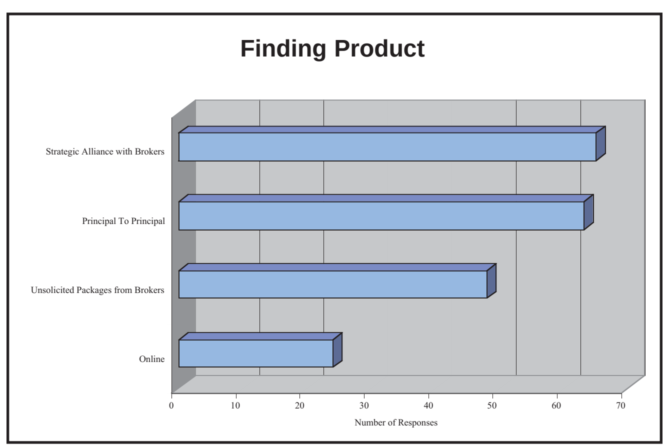
Market Conditions—How We Buy and Sell

The survey asked what types of developments/investments the respondents are seeking. When compared to what is currently in their portfolios, industrial is still ranked #1, but office and retail are strong contenders. Residential and multi-family are a distant fourth and fifth place.



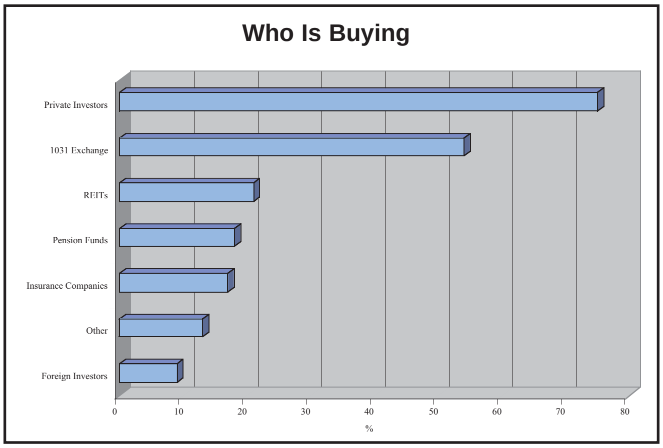
With all the barrage of Internet listing services, SIOR was interested to learn how developers find their investments. Virtually tied for first place were strategic alliances with brokers and principal-to-principal connections. Lagging in fifth place was the Internet. Convention participants echoed this response. I noted that a 10-year



trend that I am recognizing is the drop in the use of correspondents by major institutions. Most organizations now have a short list of brokers in each region that they respect and will go out of their way to use.

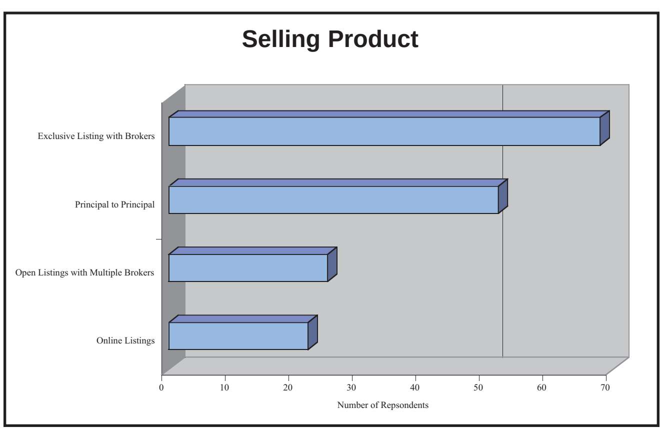
Who's Buying/How Product Sells

I used the survey to try to get a sense of who is purchasing investment properties. Those that responded placed private investors first and 1031 exchanges second.



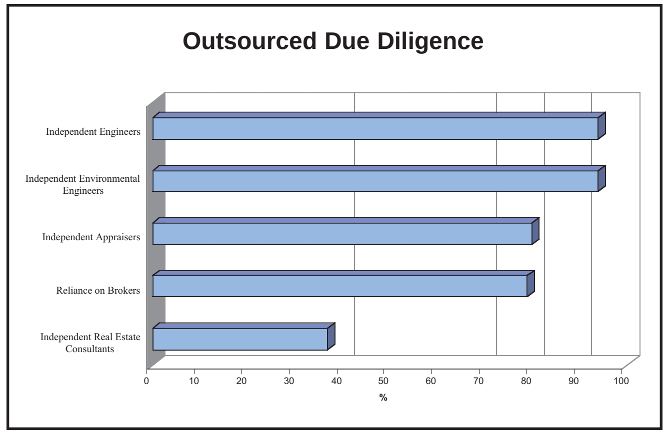
The survey also examined how investments are sold. SIOR brokers should be pleased to learn that exclusive listings outpaced open listings by 63 percent. It is interesting to note that the principal-to-principal dropped, and that online sales remained the same. One Maui participant said that he had very successfully sold a portfolio over the CCIM Web site, however, most attendees felt that good listings were never placed on the net.

Roy L. Splansky, SIOR, Venture One Real Estate, Riverwoods, Illinois, said that the main contribution the Internet has on sales is the ability to bypass printed brochures and distribute electronic information quickly (via the Internet). Major third-party due diligence reports are scanned in and sent to interested parties, saving both time and expense.



Outsourcing Due Diligence

SIOR surveyed members as to what services they are outsourcing in the investment/development world for the due diligence process. While 99 percent of the respondents said that they used internal expertise, there is a heavy usage of engineers to do property condition analyses and environmental work. Cochran pointed out that appraisers and environmental engineers often get calls from sellers in advance of a property going on the market and are, therefore, good lead sources.



It's Easy to Get Financing

The panel, audience, and survey agreed on the ease of obtaining financing. When asked about sources of capital, 78 percent of the respondents used local banks and 44 percent used insurance companies. Only three percent used REITS and one percent used securitization.

The audience in Maui had strong sentiments about fixed vs. variable rate mortgages. The survey reported that 44 percent used variable rate mortgages while 34 percent used accrual (fixed rate) loans. The debate centered on locking in low rates for the long term on a fixed basis vs. having a variable rate. The main issue voiced was the lack of flexibility with both fixed rates and securitized loans. Krumsick said that when he does obtain fixed rate loans he negotiates the right to pre-pay; it costs him more but gives him the flexibility he requires. Others felt that the chance of getting burned is stronger with a fixed rate mortgage. The concluding points were that fixed rate mortgages were sensible only when the investor's requirements are not projected to change for the length of the term, that it pays to pay for flexibility, and that there is a new hybrid fixed/variable mortgage package that is worth looking into.

The Maui participants also discussed the role of the private investor as a money source. McCormick pointed out that working with investment banks can be an expensive source of money. At Panattoni, they have 100 private investors from Sacramento alone that have invested up to $125 million.

Stephen R. Downes, SIOR, Cushman & Wakefield, New York, New York, asked if having so many real estate-related professionals in a deal made life difficult. Krumsick responded that, based on personal experience, when he deals with brokers as investors he earns a 15 percent promote, while with non-real estate investors he gets a 33 percent promote.

Returns on Investments

When asked what initial capitalization rate is generally required for an investment, 16 percent of the respondents said eight to nine percent, 33 percent said nine to 10 percent, and 46 percent said more than 10 percent.

When asked the same question for IRR returns, 25 percent said 10 to 13 percent, 34 percent said 13 to 16 percent, 16 percent said 16 to 18 percent and 26 percent said more than 26 percent.

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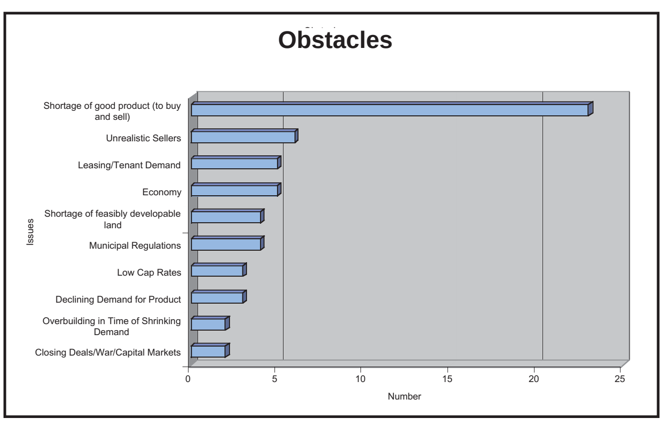
Krumsick said that IRRs don't work for him; consequently, he has not used them for more than 10 years. He said that they remain bullish on industrial and retail with a bit of office. He advised that investors look at the ongoing cost of the investment, as the Achilles Heel of returns is the "below the line" items such as tenant improvements and commissions. He estimated that warehouse costs are less than five percent of the gross, while strip retail is running 10 to 15 percent; office costs are higher yet again.

Neil E. Merin, CCIM, SIOR, NAI Merin Hunter Codman, West Palm Beach, Florida, says that retail is the #1 investment in Florida as well as other major population growth areas. While there is safety in retail, there is not the return; therefore they are investing in office where they are seeing a 200-basis differential. **Lance C. Ross, SIOR,** Cushman & Wakefield of Arizona, Phoenix, Arizona, pointed out how the timing of buying product has an impact on the return. He still sees the better returns on retail.

Wilkinson said that institutional criteria and return needed are different from that of local deals, so looking at needed returns is not a universal answer. Some good investment deals can be had in properties with some (not all) credit tenants, but these buildings do not meet institutional criteria.

Obstacles

The major obstacle voiced by 78 percent of the respondents was the difficulty in finding quality product. The audience agreed that many of their investors look at refinancing and holding as the best alternative at this time. Krumsick said that the basic fundamentals are out of kilter, and there is no reason for him to sell a building that is 25 percent vacant. He will ride this storm out and sell when occupancy goes back up.



The Maui conventioneers did come up with creative ways to find product. Downes said the places to look for product are markets that are hard to enter. Hurdles exist, such as the time it takes to break into these markets. It can pay to bring in a local partner. Merin chooses to look to institutional investments that have a liquidity requirement to sell. Wilkinson advised that institutions have a pack mentality that lead to "sell" decisions. While these may not be institutional grade, local investors may find them attractive alternatives. Krumsick said that the top twelve investors in Wichita (they call themselves "The Dirty Dozen") meet once a month to stay on top of the market.

The Maui attendees also addressed other obstacles that the brokerage community faces. There was a mixed view as to principals excluding brokers and trying to go direct. Wilkinson said that brokers try to go direct and exclude other brokers. Merin is seeing that sellers do not want to pay fees to buyer's representatives, but is not sure if this is a philosophical issue or a cost issue. Splansky said that while they tell the buyer's reps their fees are excluded from the deal, institutional owners are savvy and understand that all fees are part of the transaction. McCormick said that at Panattoni they allowed brokers 30 days to work their own lists; after that they distribute the listing to the open market.

Conclusion—Relationships Rule

The highlights of the online questionnaire and the Maui Shop Talk are:

1. Our SIOR members are a formidable investment and development group.

2. Successful professionals must refine and adjust their game plan to reflect the changing market scene. Good investment projects can be found, but require more thought and creativity to find and list.

3. Finding financing is easy; finding good product is hard. Investors and developers are using multiple sources for finding product, but still find that long-term strategic alliances bring them the best product. The brokers who have good listings will have no trouble selling the assets and should consider getting equity interest from the purchaser. (Krumsick said that brokers with product could get 10 to 30 percent of the deal as part of the negotiations.)

4. The bottom line? When all is said and done, real estate is a relationship business. People still work with those that they know and trust—to list, lease, or acquire assets. ❖