Rich Rydstrom on Which CRE Sectors Will Be The First To Fully Recover?

by Phil Hall

As the economy begins to stabilize, the commercial real estate (CRE) industry is also experiencing stirrings of recovery. However, CRE's revival appears to be coming in fits and starts, with some sectors enjoying faster and deeper prosperity, and others continuing to deal with a myriad of problems.

The very good news in CRE is primarily within the multifamily sector. According to data released by New York-based Integra Realty Resources Inc. (IRR), multifamily was the first to rebound after the recession, with 81% of the sector's markets reporting to be in a recovery or expansion phase during 2010.

But according to Ed Mermelstein, partner with New York-based corporate and real estate law firm Rheem Bell & Mermelstein, the multifamily sector had extra help that the other CRE sectors lacked.

"Multifamily, as far as I'm concerned, not only recovered, but never really felt the pain of the rest of the CRE sector due, in large part, to Fannie Mae and Freddie Mac supporting the residential aspect of the market," he explains.

"It was an artificial support, but a support nonetheless. Multifamily has not only surged in the last few months, but it is one of the sectors to maintain financing while the rest of the commercial sectors struggled," Mermelstein comments.

Linda L. Zelm, founder and president of St. Paul, Minn.-based Small Business Real Estate Advisors, adds that the multifamily sector's success can also be attributed to the convulsions facing the residential mortgage market.

"Multifamily will continue to be the most healthy sector because of the new difficulty in buying a home," she says. "From making large down payments to the stricter income requirements and credit scrutiny required by lenders, the American Dream is going to be much harder for people under 40 to achieve. Thus, they will have to rent."

Zelm points out that further growth in the multifamily sector may also impact U.S. housing trends.

"Our society is mostly an owner society, except for some very large cities like New York," she continues. "Will it become a tenant society, like much of Europe? I cannot predict, but I hope not, because owning a home is central to how Americans think of themselves. I would hate to see that go away."

Richard Rydstrom, chairman of the Los Angeles-based Coalition of Mortgage Industry Solutions, believes the multifamily sector will eventually calm down.

"As vacant and real estate owned homes enter the rental marketplace, many families will choose single-family homes over multifamily," he says. "New homeowners will not enter the marketplace at rates historically seen in the past - there is still trepidation of the unknown after witnessing what happened to many displaced homeowners, as well as the new loan origination requirements. However, this will subside over time."

Beyond multifamily, however, opinions are mixed regarding which CRE sector is showing significant signs of improvement. IRR's data found industrial real estate vacancy rates at 10.85% in 2010, up from 10.17% in 2009, while planned development dropped from 197.1 million square feet in 2009 to 184.3 million square feet in 2010.

Yet Bob Bach, senior economist with Grubb & Ellis Co., based in Santa Ana, Calif., believes that the industrial sector will be the next to surge forward.

"The sector will benefit from the rebound in the import-export markets," he says. "We will have strong export volumes that are tied to the weak dollar, while the import markets are tied to the increases in business spending and a modest recovery in consumer spending."

However, Jeffrey M. Finn, president and CEO of NAI Global, based in Princeton, N.J., predicts that the hospitality sector is primed for a speedy comeback.

"As the economy improves, business travelers are on the move again," he explains. "We're seeing this as a national trend, though in general, the major markets are doing better than the secondary markets. The higher-quality assets - the urban, Class-A trophy properties - are being sought after, with the major funds looking to them for yield."

Still, some industry experts believe that retail is next in line for a boost.

"Retail will be the second sector to grow, as income and discretionary funding become available," says Richard J. Rennell Jr., senior vice president at Resource Title Agency, based in Cleveland.

"Over the last 18 to 24 months, we've gone from no spending to a state of spending more, as evidenced by the recent Christmas season, which was the best retail season in three years," he notes.

Bill Looney, president of U.S. loan sales for Boston-based DebtX, believes the retail sector will only move forward in certain markets.

"Within retail, we need to look at the individual properties," he says. "There are plenty of good, strong retail locations, although there are some that are in more distress."

But Zelm, a past president of Minnesota Commercial Real Estate Women and the Minnesota Shopping Center Association, is not optimistic about the retail sector.

"Retail is a disaster and will be for a number of years as retailers shrink, merge with others, go out of business and expand their Internet presence," she says. "Retail has been my specialty for the past 25 years, and I no longer see it as a viable specialty in commercial real estate."

As for the office sector, CRE experts believe this will be the last to fully recover its footing. Rennell cites corporate downsizing and consolidations, along with high unemployment, as contributing factors, although he adds that recovery will eventually come around.

"With more growth in the economy, we will see more hiring and new companies coming out of the ashes," he predicts. "The owners of office buildings will be marketing their properties more aggressively."

Bach adds that this trend is already being seen in several markets.

"There is a high demand by investors for properties in primary markets like Washington, New York, parts of San Francisco, Boston and Los Angeles," he says. "Lenders are competing to finance these properties."

{CMI_DEALMAKERS}

AL: Arch Street Apartments, Madison

WHAT: A 267-unit, garden-style apartment community built in 2009. Amenities include an outdoor pool, barbeque area, fitness center, children's playroom, pet-walk area, lounge/business center and gated access. The property was 93% leased at closing.

WHO: Walker & Dunlop LLC closed the loan, which was originated by Uniquities LLC.

$$$: $21.2 million.

TERMS: The loan was structured with a 10-year term with two years interest-only utilizing Fannie Mae's DUS product. The loan was underwritten to a 79.3% loan-to-value with a 1.25x debt-service-coverage ratio.

Walker & Dunlop: (212) 953-7301.

NJ: 70 Eisenhower Dr., Paramus

WHAT: A 38,000 square-foot office facility that is currently 100% occupied by tenants that include the Ridgewood Montessori School and BounceU, a recreational party-and-play facility. Originally built in 1966 and extensively renovated in 1987 and 2009, the property sits on 2.28 acres.

WHO: CB Richard Ellis obtained financing from a local commercial bank on behalf of the borrower, Millstein Paramus LLC.

$$$: $4.78 million.

TERMS: The nonrecourse, fixed-rate loan carries a five-year term.

CB Richard Ellis: (201) 556-9800

IL: Hillsboro Rehabilitation and Health Care Center, Hillsboro

WHAT: A 107-bed skilled-nursing facility.

WHO: Cambridge Realty Capital closed the loan for the owner, a Missouri-based limited liability company.

$$$: $2.16 million.

TERMS: The FHA-insured HUD LEAN loan amortizes over a 26-year term.

Cambridge Realty Capital: (312) 357-1601
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