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# Commercial Real Estate Outlook 2013: It's Déjà Vu All Over Again

CoreNet Global: Seattle

James R. DeLisle, Ph.D.

February 19, 2013

# Overview

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- Respondent Profile
- Market Timing
  
- Part I: Economic Outlook
- Part II: Capital Market Overview
- Part III: Real Estate Market Outlook
- Part IV: Challenges, Issues and Opportunities

# What Do You Want Me To Talk About?

## 2012 Topics

# 2013 Topical Potpourri



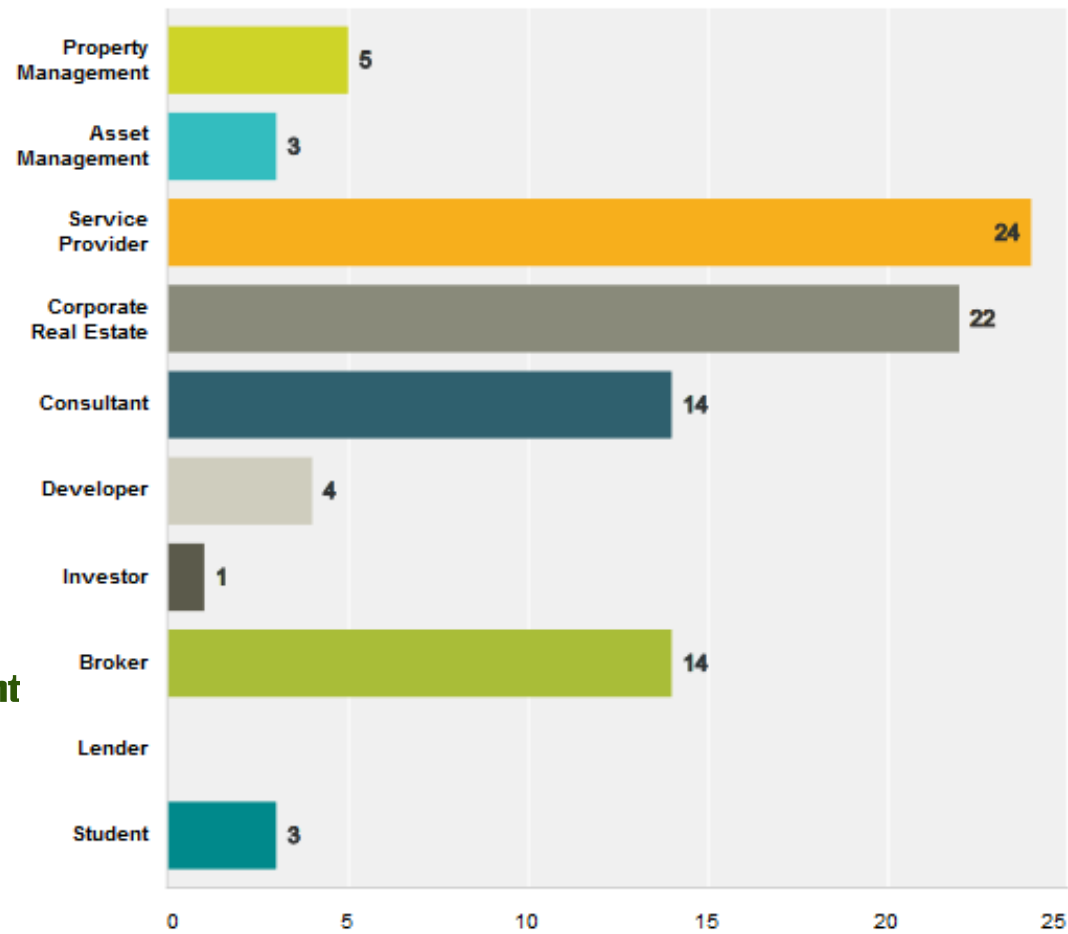
# Professional Roles and Career Plans

## Other Industry Roles



Which of the following best describes your role with respect to the real estate market?

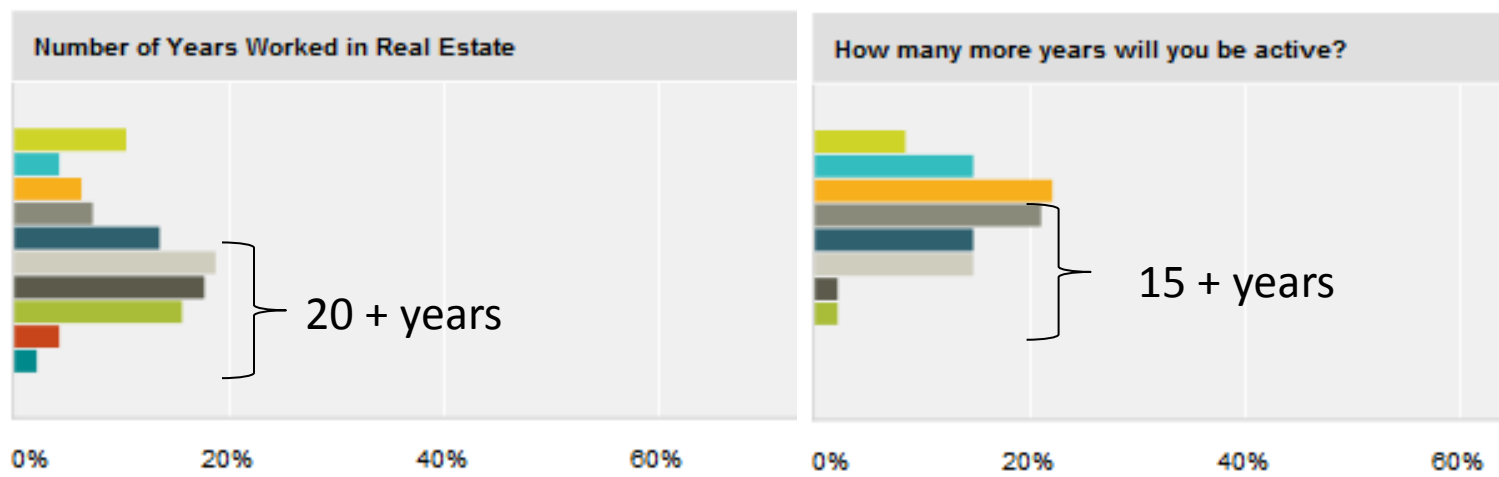
Answered: 90 Skipped: 9



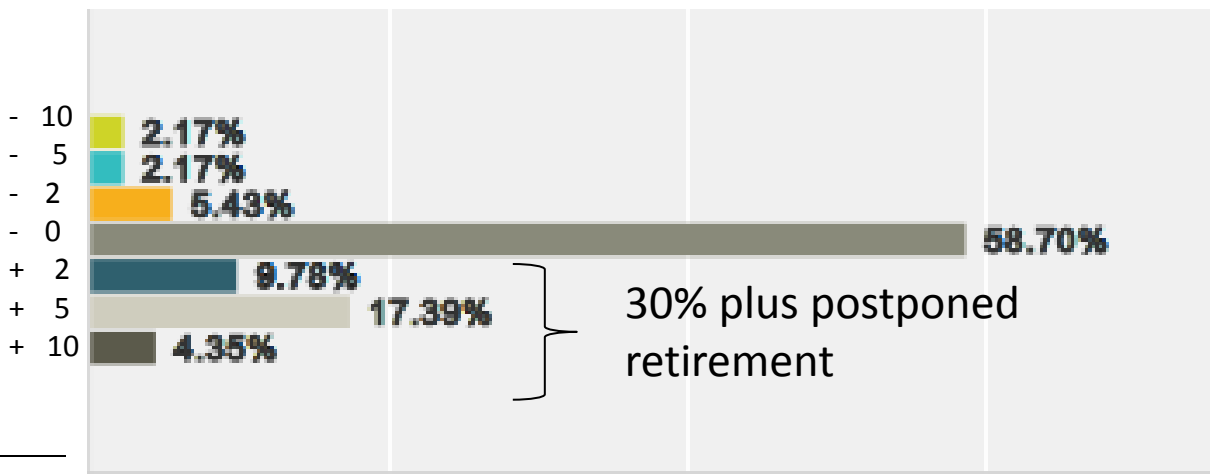
# Experience in Real Estate: Past and Future

Number of Years in RE to Date

Number of More Years in RE to Date



Change in Retirement Due to Recession



# Part I: Economic Environment for Real Estate

## 2010 Outlook

- Recession over; slow recovery; some downside risk
- Big businesses okay, Small struggling, stock market up
- Consumers guarded; CEOs hopeful

## 2011 Outlook

- Recession really over? slow recovery; some downside risk
- Big business bragging profits up; small business lagging.....
- Consumers wanna do it; CEOs hopeful

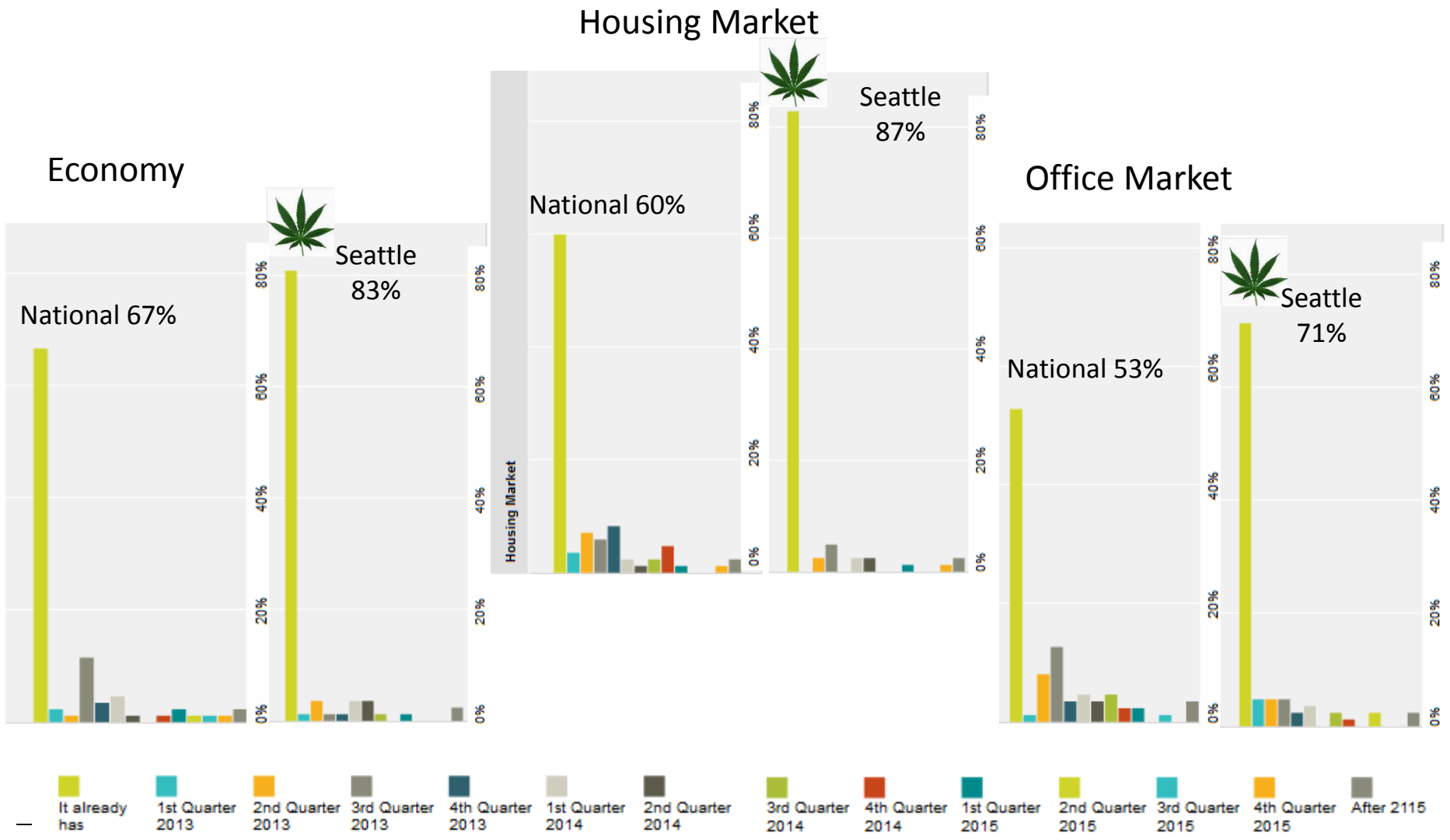
## 2012 Outlook

- Limited Double-dip. Slow recovery at best; downside risk
- Big business balance sheets okay; small business stabilizing..
- Consumer and CEOs defensive but willing... improvement...

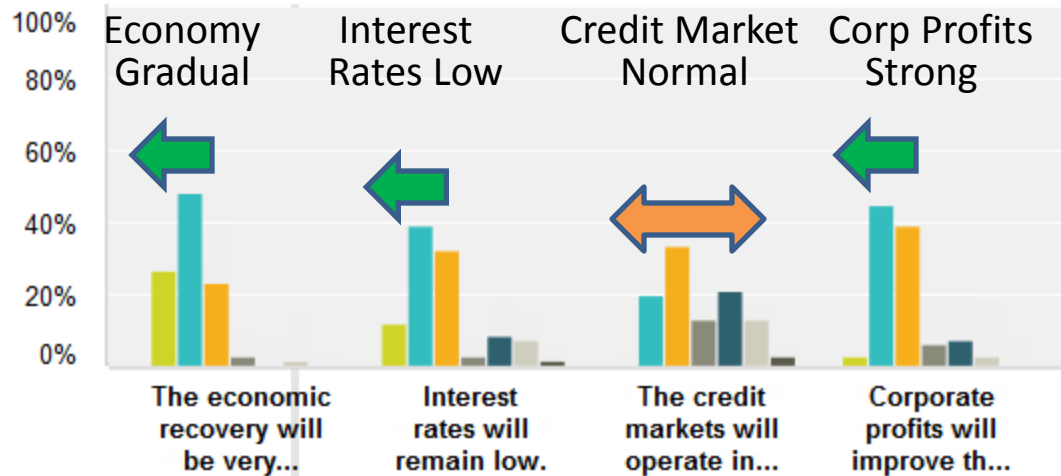
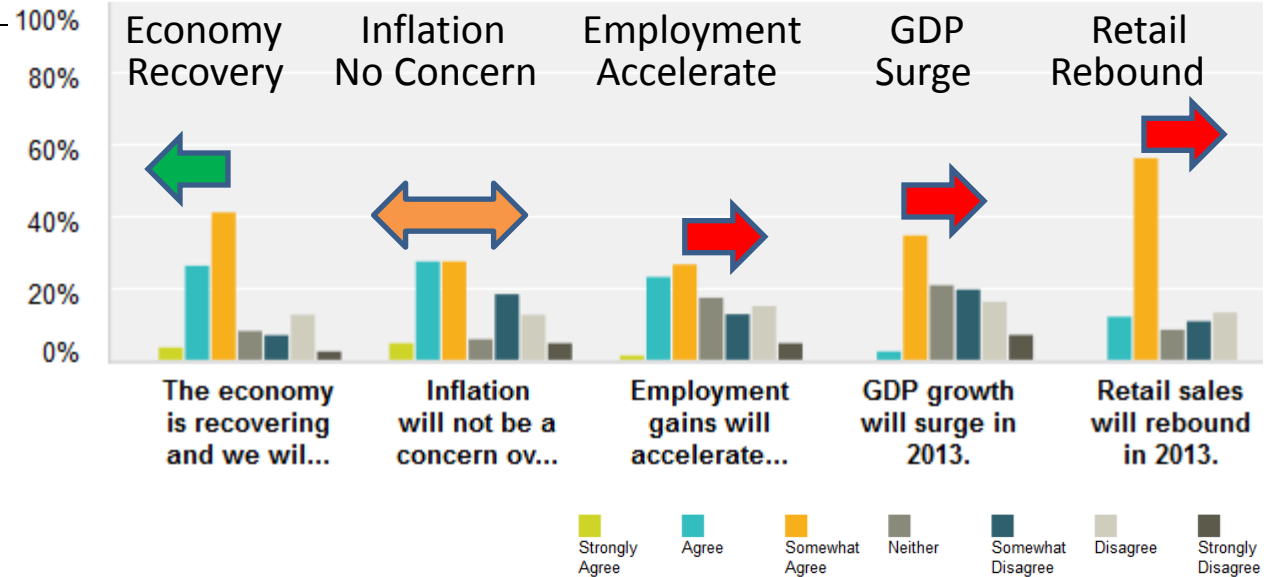
## 2013 Outlook

- Potential slip; slow at best; political unrest
- Big business profits soaring; small business hanging
- Consumers and CEO hangover; cliff deferred not preferred...

# Market Timing: National vs. Seattle



# Economic Outlook: Agree/Disagree





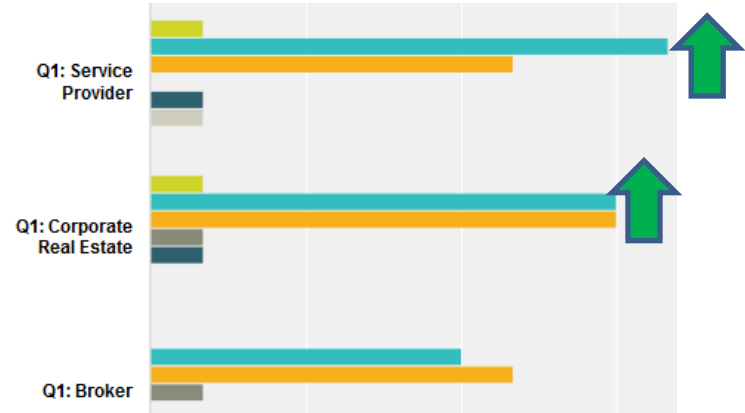
# Comparisons Among CoreNet Categories

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## GDP Growth Surge



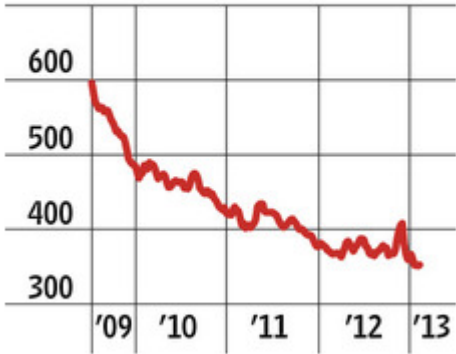
## Corporate Profits Up



# Employment and Wages



Initial jobless claims, four-week moving average, in thousands



Source: Labor Department



university of washington pay raise

20,300,000 RESULTS

[Salary and Wage Increase Restrictions](#)

POLITICS | Updated February 13, 2013, 7:51 p.m. ET

## Minimum-Wage Maneuvering Begins

Article | Video | Comments (139)

Email | Print | Save | Facebook | Twitter | Google+ | LinkedIn

By KRISTINA PETERSON



In the first State of the Union of his second term, President Barack Obama pushed to raise the Federal minimum wage to \$9 an hour, reviving a dormant debate. Photo: Getty Images.

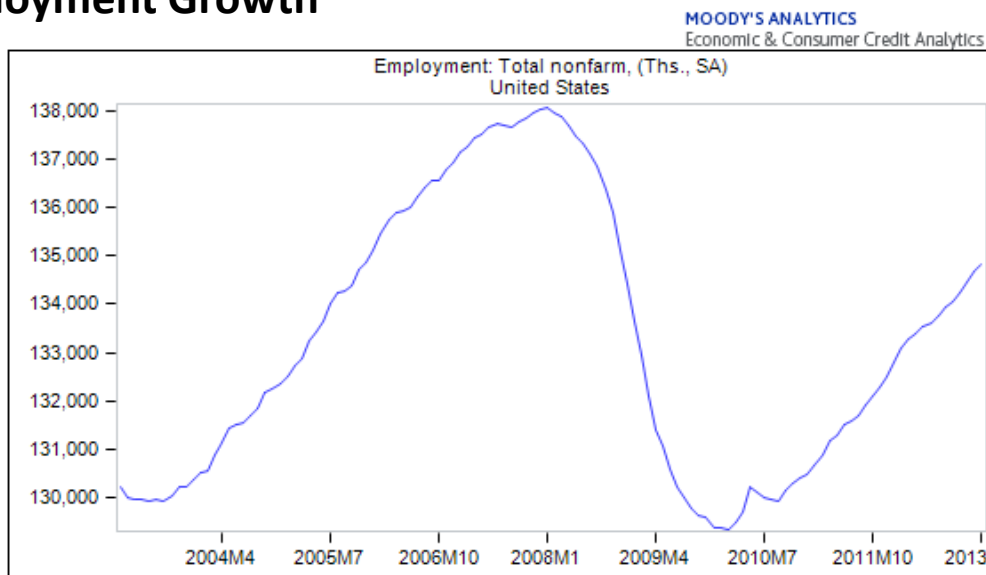
## Staff Salary/Wage Increase Restrictions July 1, 2011 - June 30, 2013

[CONTENTS](#)

[UNDERSTAND](#)

[Salary/Wage Increase Restrictions and Exemptions](#)

## Employment Growth



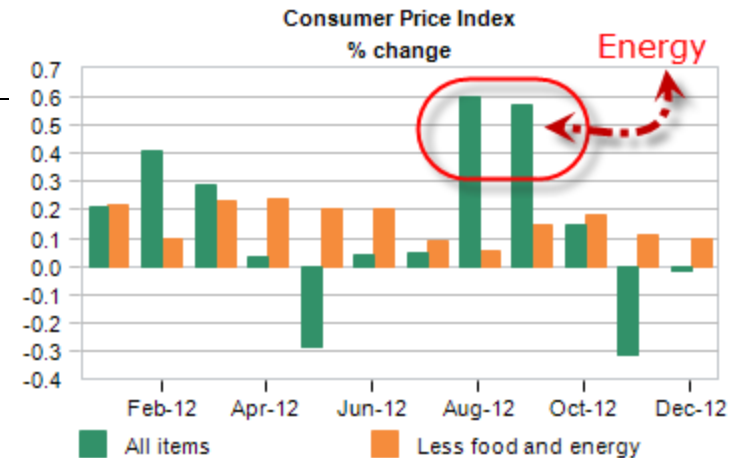
# Inflation & Interest Rates

## Bernanke reiterates commitment to record easing

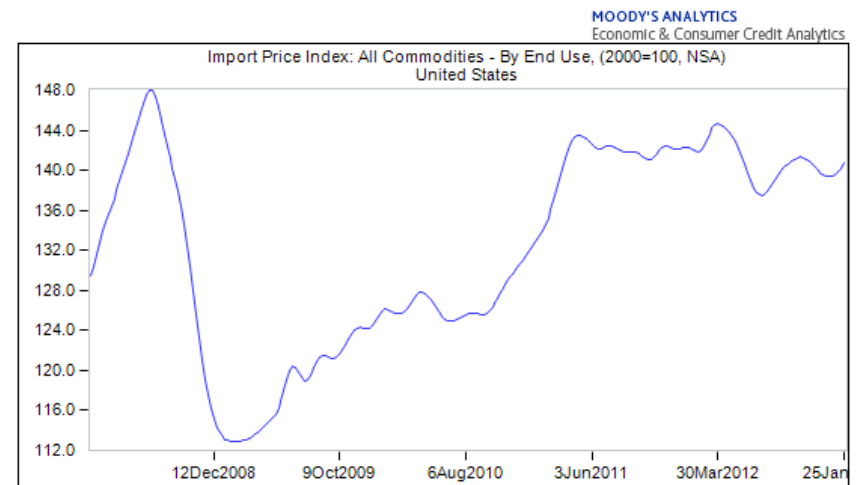
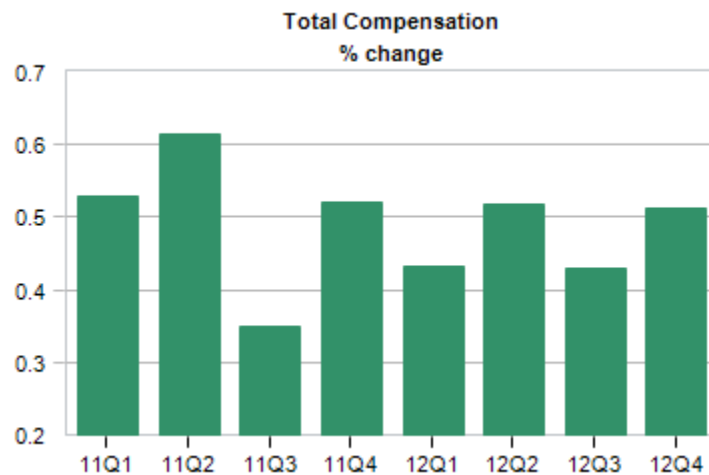
2/18/13 12:12pm

“Federal Reserve Chairman Ben Bernanke said the U.S. economy is far from operating at full strength and reiterated his commitment to record easing.

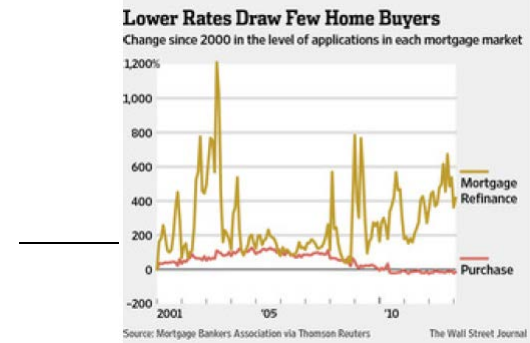
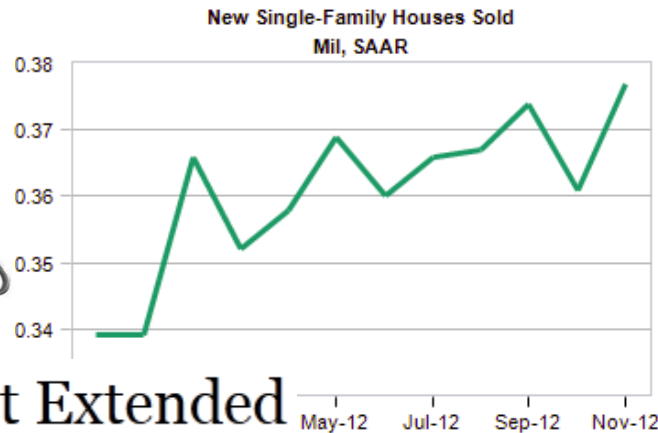
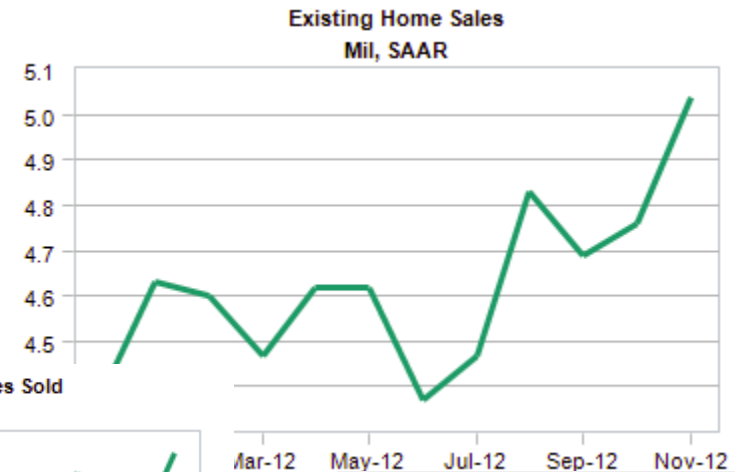
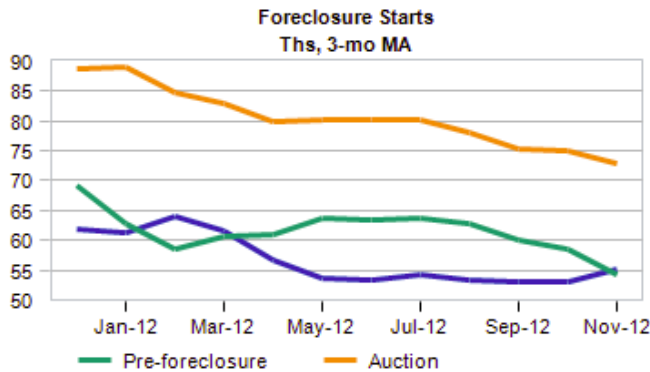
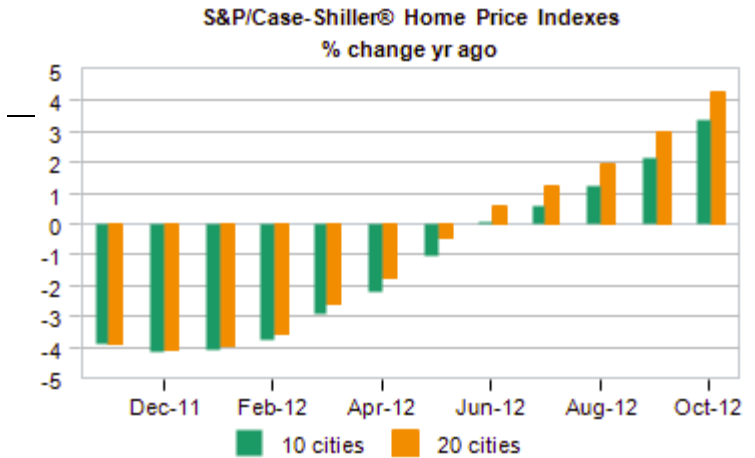
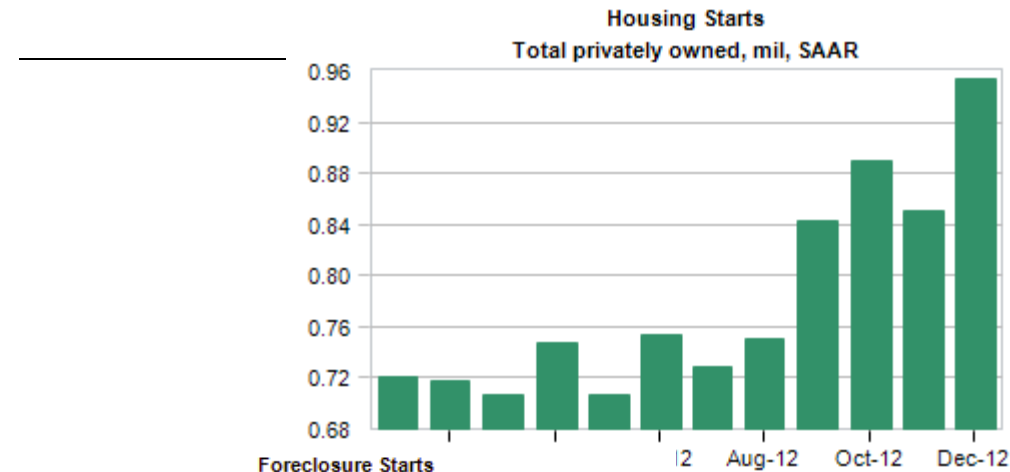
“With unemployment at almost 8 percent, we are still far from the fully healthy and vibrant conditions that we would like to see,” Bernanke said today at a meeting in Moscow of his counterparts from the Group of 20. “The United States is using domestic policy tools to advance domestic objectives.”



## Import Price Index: 5 years



# Housing Trends



## Mortgage Debt Relief Act Extended

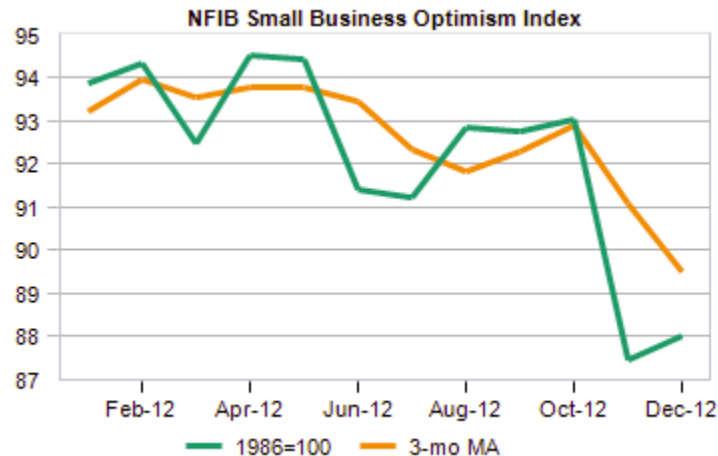
# Gridlock, TINR, Politics & Small Business Confidence,

## T I N R

### House Vote 30 - Approves Three-Month Debt Limit Extension

Yes	285	86 Democrats	199 Republicans	215 needed to pass
No	144	111 Democrats	33	
Present	0			
Didn't vote	3			

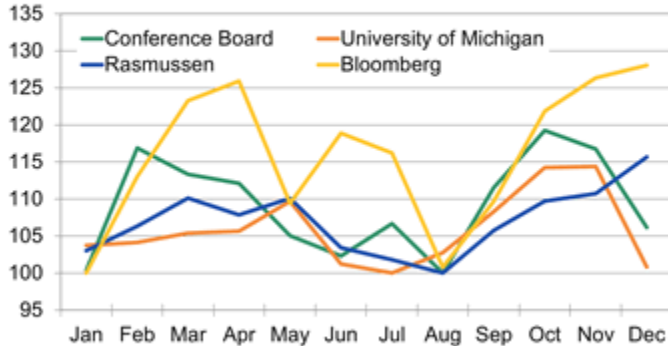
Result: Passed by a margin of 70 votes  
Date of Vote: January 23, 2013



# Consumer Confidence & Consumption

## Different Surveys, Different Trajectories

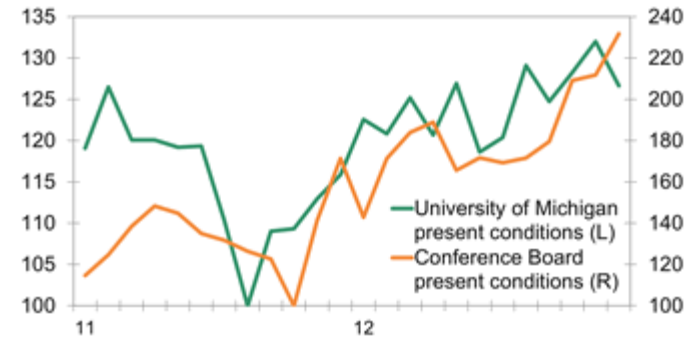
Consumer confidence, trough=100, 2012



Sources: Bloomberg, The Conference Board, U. of Michigan, Rasmussen, Moody's Analytics

## Consumers More Optimistic About the Present

Consumer confidence, present conditions, trough=100



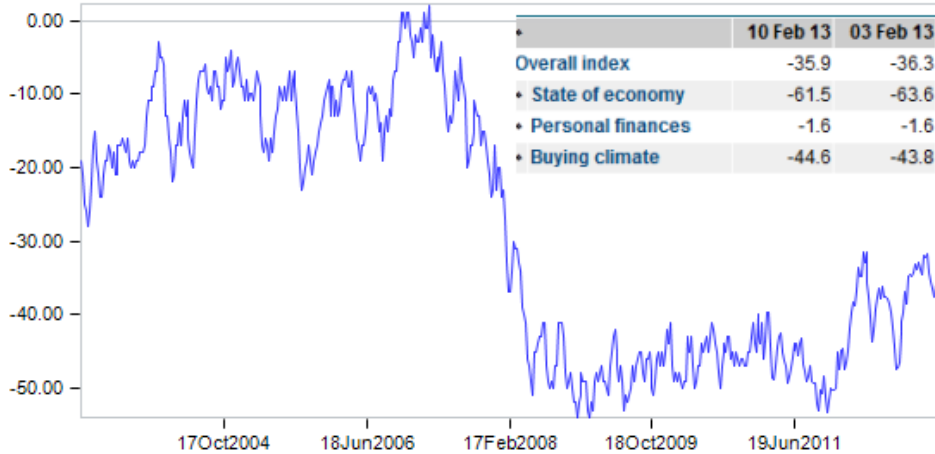
Sources: The Conference Board, University of Michigan, Moody's Analytics

## Headlines & Headwinds

## Longer Term Perspective

MOODY'S ANALYTICS  
Economic & Consumer Credit Analytics

Consumer Comfort Index: Overall, (Index, NSA)  
United States



## 401(k) breaches undermining retirement security for millions

By Michael A. Fletcher, Published: January 14 | Updated: Tuesday, January 15, 6:34 AM

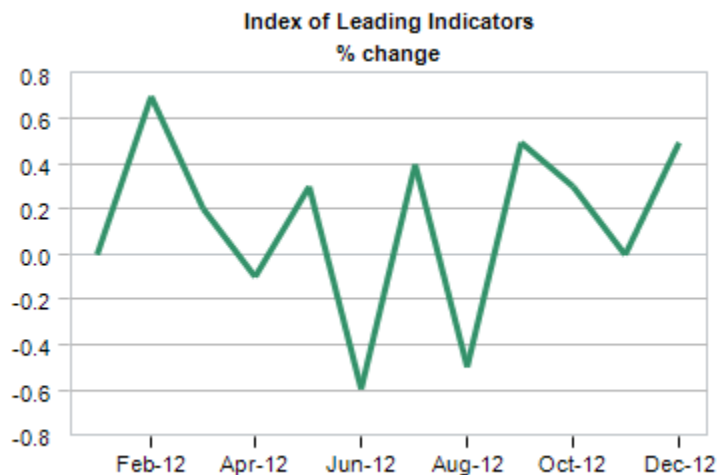
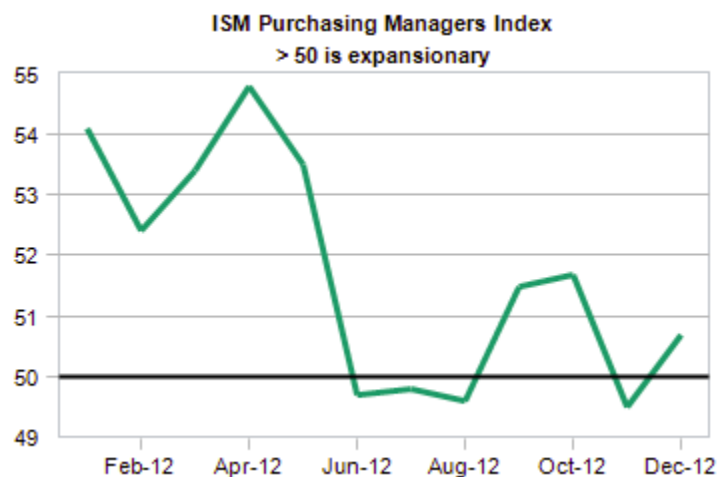
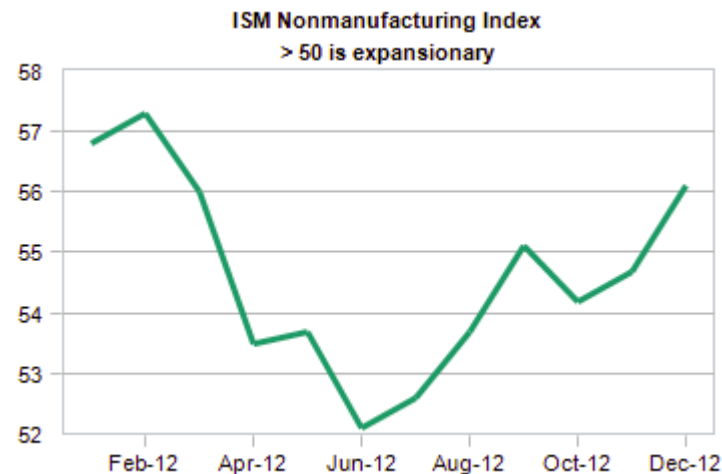
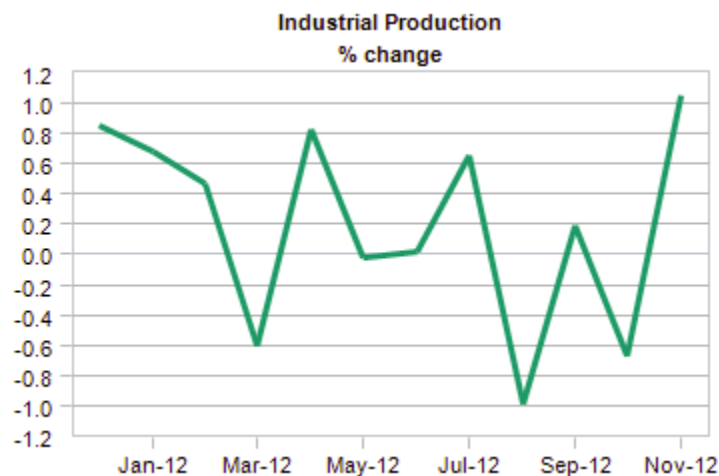
BUSINESS | Updated January 13, 2013, 7:48 p.m. ET

## Retailers Fear Payroll Tax Will Cut Consumer Spending



# Leading Indicators: déjà vu all over again?

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# Market Reactions: Investors & Consumers

DJIA News Stories DJIA SPX



## Stock Mutual Fund Flows: 4Q12

### Follow the Money

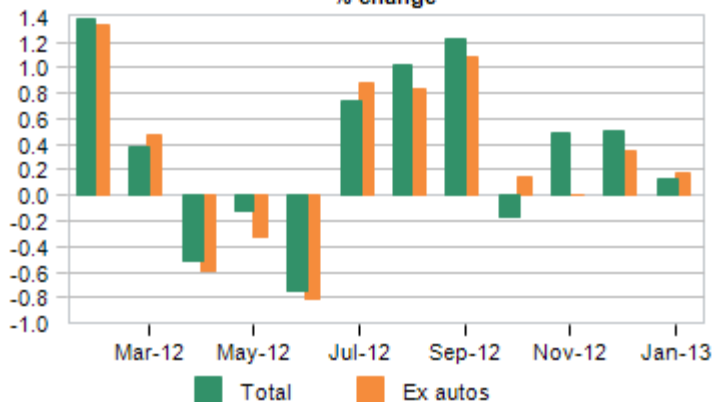
Quarterly flow of investor cash by fund type, in billions\*



\*Estimated  
Source: Investment Co. Institute

## Consumers: Wait & See

Retail Sales  
% change



ECONOMY | February 18, 2013, 8:42 a.m. ET

## Bonds: Pressure on Spreads

### Playing the Spread

Investors flocking to higher yield investments have narrowed the spread between investment-grade corporate bond yields and 10-year Treasury yields.



## Consumption to Remain Restrained

© JR DeLisle, Ph.D.

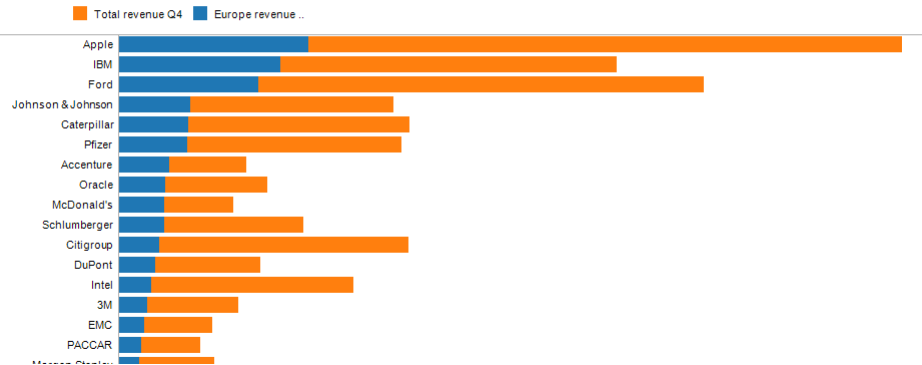
Dismal.com; WSJ.online



# The Global Scene

## Earnings in Europe and the U.S.

U.S. corporations have largely skirted major damage from the European financial crisis, but they will likely face more trouble ahead. Compare the total revenue with revenue generated in Europe in the fourth quarter for 39 companies with significant sales in Europe, and the change in revenues.



AGENDA | Updated February 18, 2013, 7:07 a.m. ET

## There's a Feeling of Instability Bubbling Up

There's a back to the future feel about the global economy right now. The only question is back to what future? The obvious answer considering the events of the past week is the 1970s. There are plenty of echoes in the world today of the currency instability, rising inflation, rising unemployment and political uncertainty that marked that troubled decade.



## Fixed Asset Investment Value

Trillions yuan

¥36.48  
trillion

2011

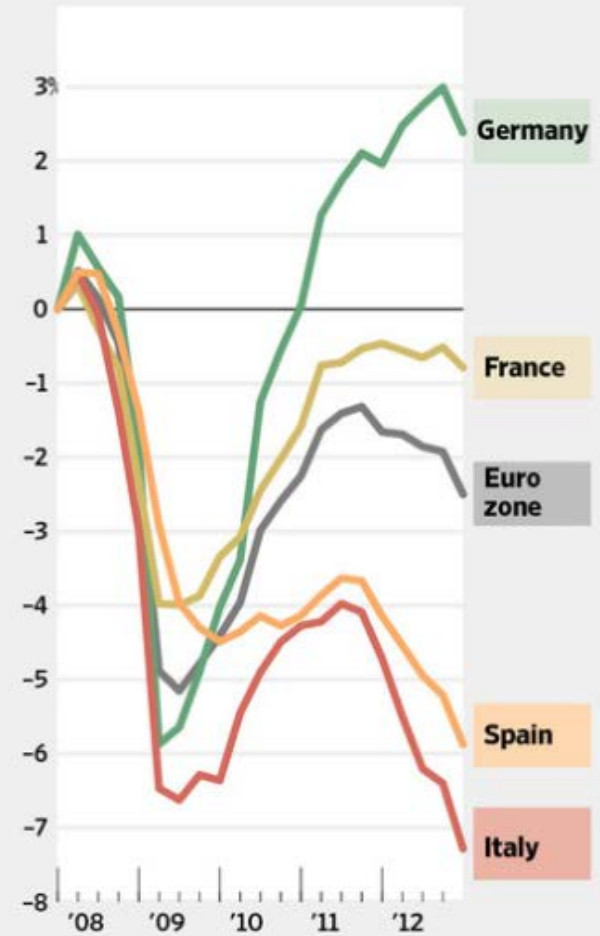
## China



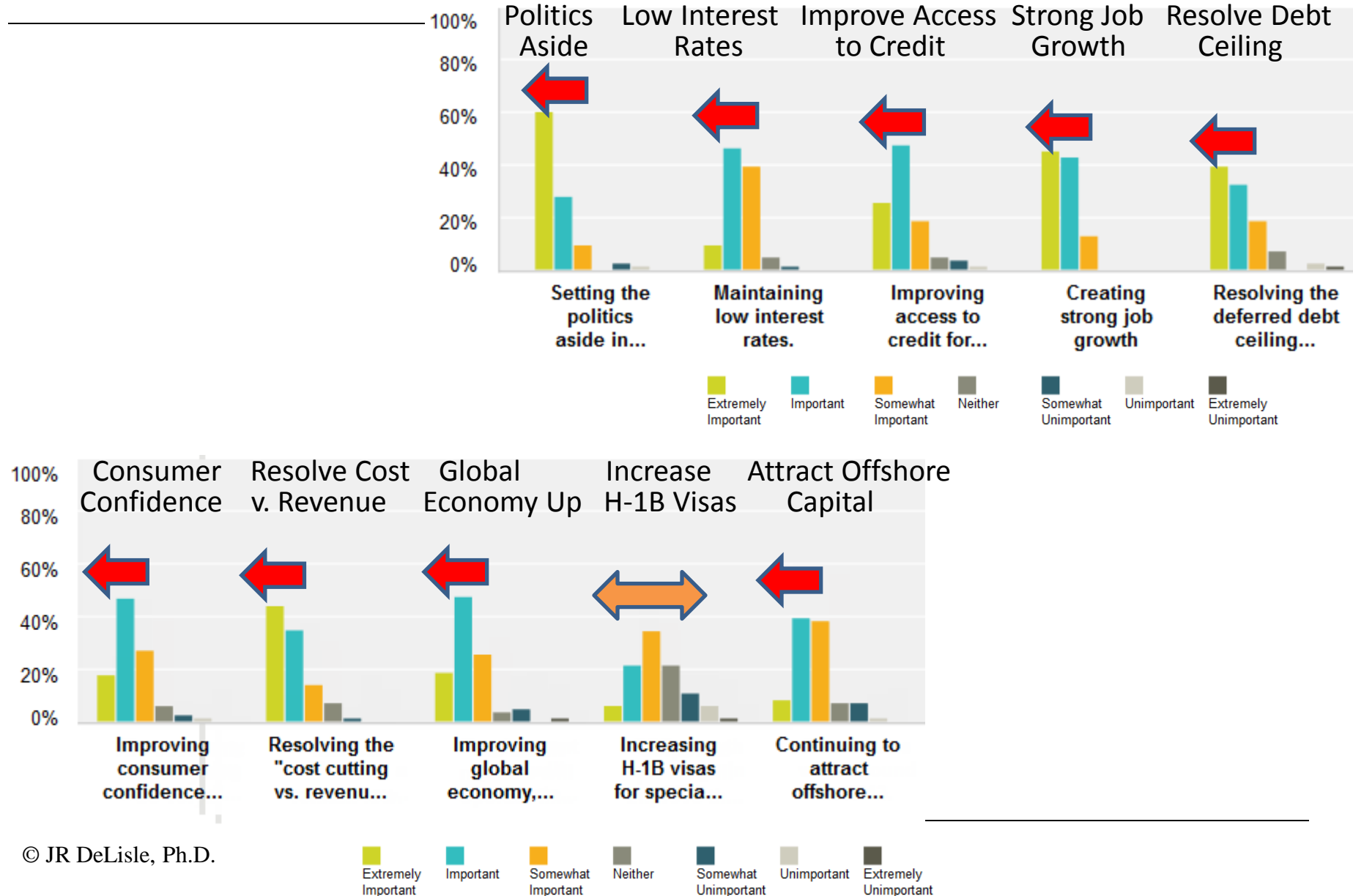
## Losing Ground | The euro

### Change since 2007 in GDP

Adjusted for inflation and the seasons



# Importance of Factors to Sustainable Recovery



## Risks in 2013



# Part II: Real Estate Capital Markets

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## 2010 Market

- Tentative, waiting, new players & rules
- Rising Cap rates, declining values de-capitalizing
- Challenges re-levering; credit crunch for asset class

## 2011 Market

- Patient pouncers, old rules, core rules
- Cap rate halos; values unknown...
- Re-levering at top only; credit crunch for rest

## 2012 Market

- Top-end frenzy, core investor apprehension
- Cap rate compression, spread investment
- Window opening, headwinds closing, distress unrest

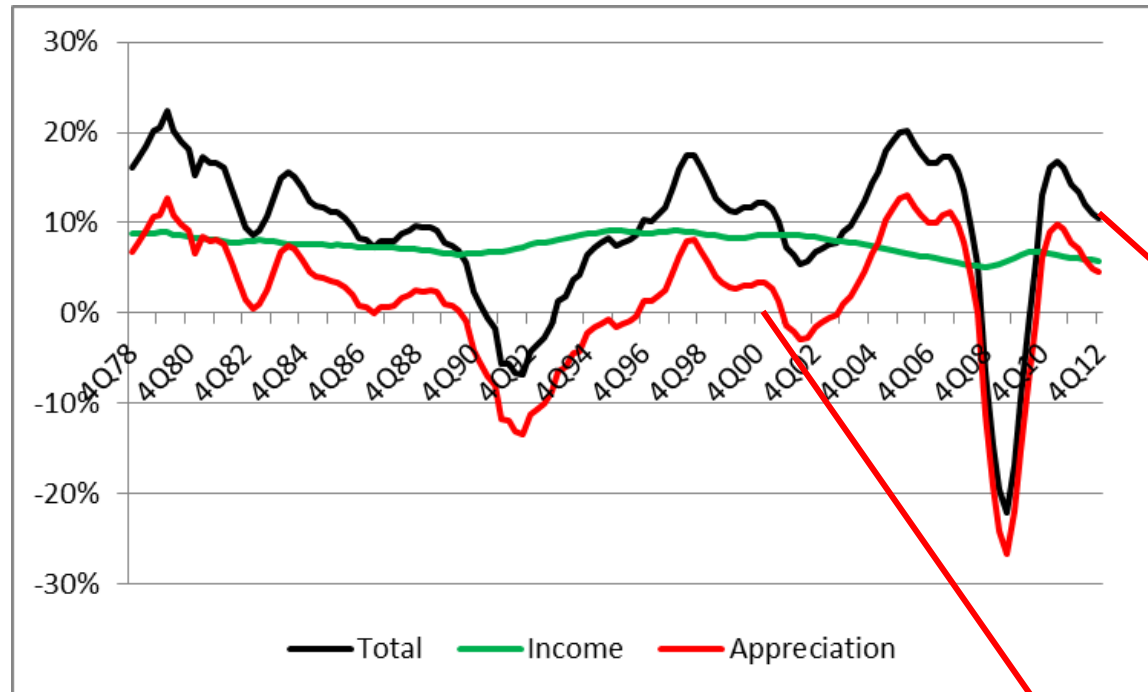
## 2013 Market

- Top-end frenetic, core fanatic
- Cap rate regression, acquisition aggression
- Winds are blowing, deal junkies are crowing, déjà vu again...

# How We're Doing: National Private Real Estate

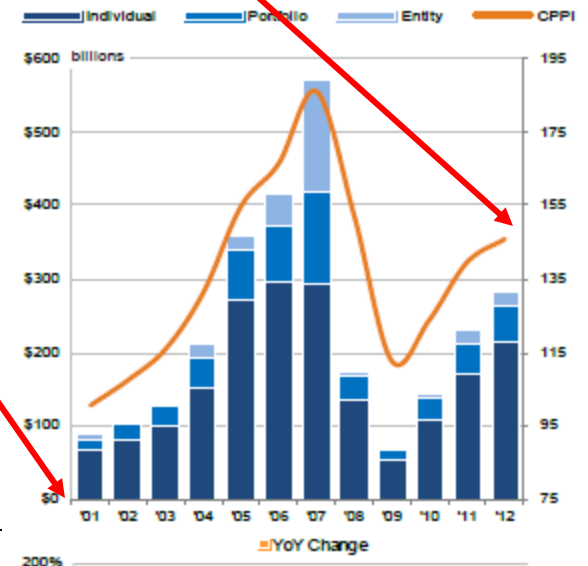
	Market Value (\$ Millions)			4th Quarter 2012 Returns	3rd Quarter 2012 Returns	1 Year Returns
	Percent of Total	Number of Properties				
<b>NCREIF Property Index</b>						
<b>Total Index</b>	319,951.4	7,270	Total	2.54	2.34	10.5
	100.0%		Income	1.41	1.42	5.8
			Appreciation	1.13	0.92	4.5
<b>Property Type Subindexes</b>						
<b>Apartment</b>	80,570.8	1,514	Total	2.81	2.43	11.2
	25.2%		Income	1.31	1.31	5.4
			Appreciation	1.49	1.11	5.6
<b>Hotel</b>	8,274.0	243	Total	2.24	2.14	8.2
	2.6%		Income	1.82	1.86	7.3
			Appreciation	0.41	0.28	0.9
<b>Industrial</b>	45,321.8	2,974	Total	2.37	2.32	10.7
	14.2%		Income	1.49	1.51	6.3
			Appreciation	0.88	0.81	4.3
<b>Office</b>	112,724.6	1,426	Total	2.17	2.32	9.5
	35.2%		Income	1.35	1.38	5.7
			Appreciation	0.82	0.94	3.7
<b>Retail</b>	73,060.2	1,113	Total	2.97	2.31	11.6
	22.8%		Income	1.52	1.50	6.2
			Appreciation	1.45	0.82	5.2

# NCREIF NPI Returns & RCA Transaction Volume



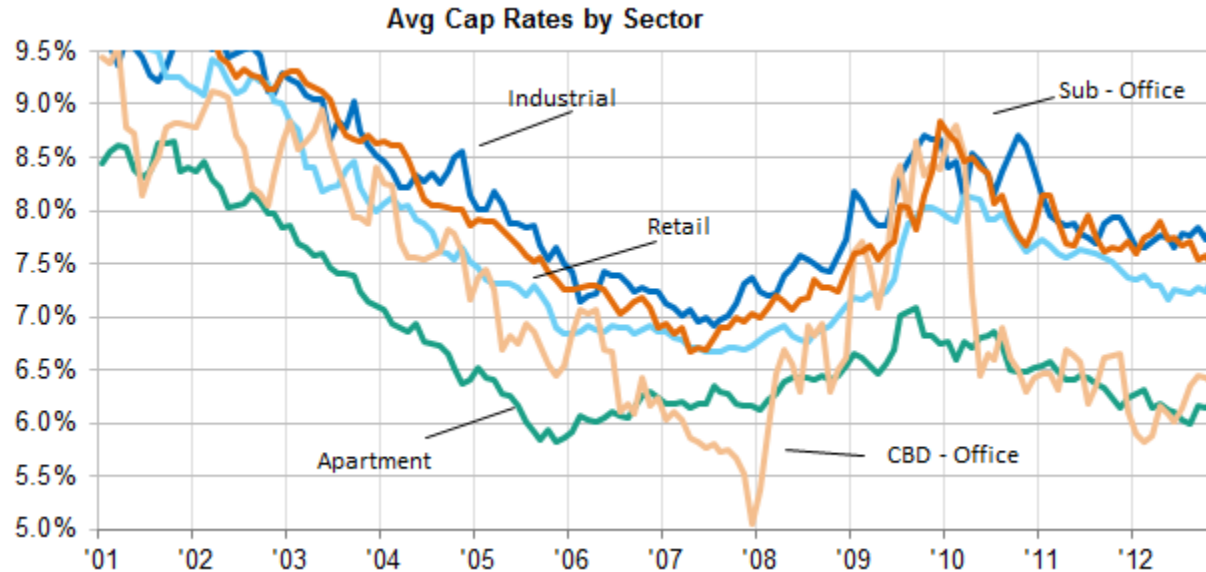
## Year in Review

### Annual Sales Volume and Pricing Trends

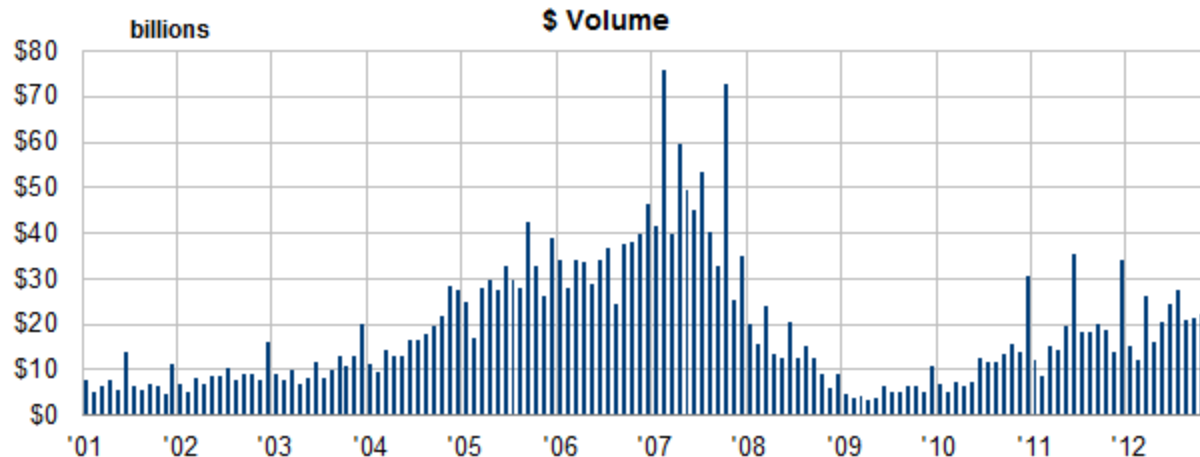


# National Cap Rates by Ptype & Volume

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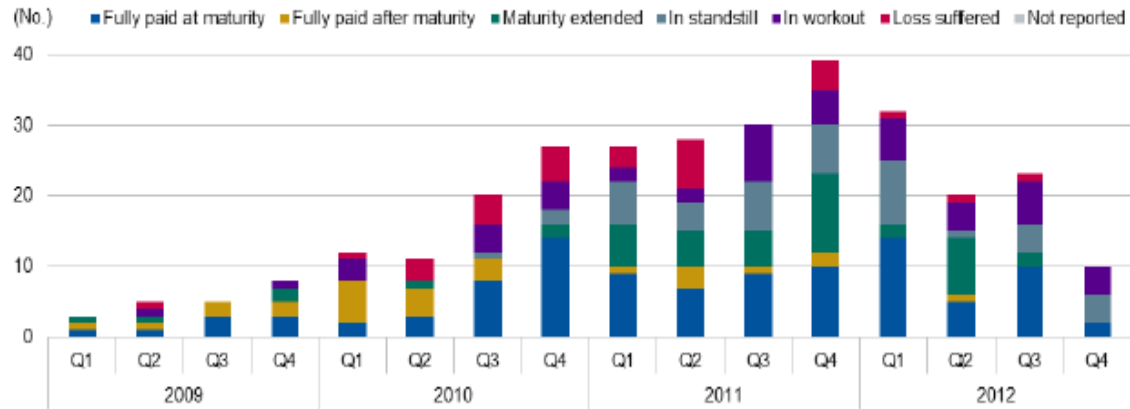


## Transaction Volume



# Commercial Loan Maturities & Default Trends

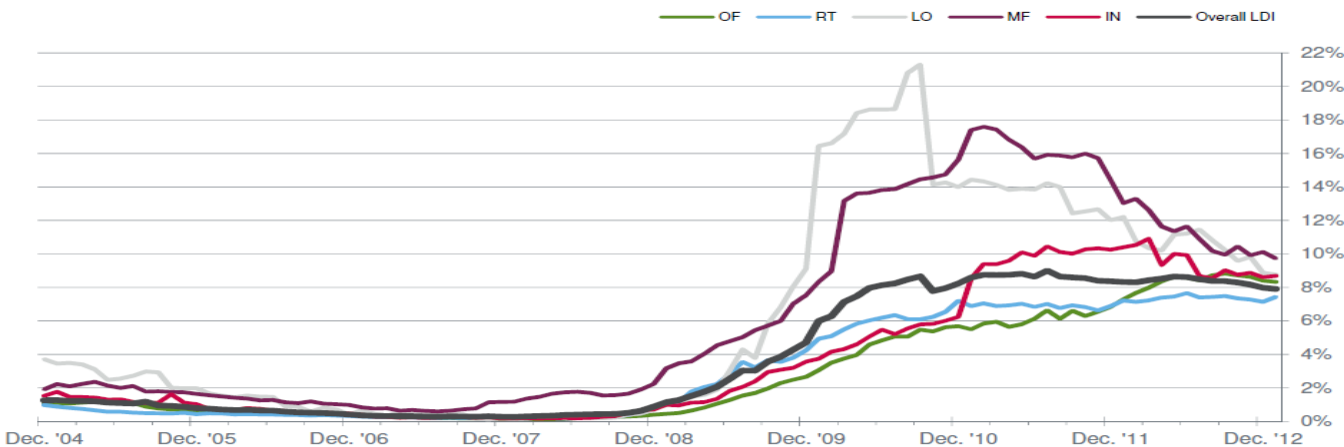
**Maturity Outcomes**  
by Number of Loans



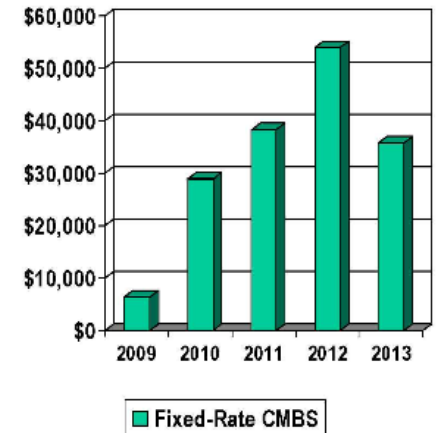
Source: Fitch

## CMBS Loan Delinquencies by Property Type: 2004—Present

7.91% as of January 2013



## Maturities



Source: Fitch Ratings





# Part III: Spatial Market Fundamentals

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## 2010 Spatial Market

- Still weakening, negative absorption; more downside risk
- Vacancy rates pushing records, rents declining
- Negative absorption, lagged recovery

## 2011 Spatial Market

- Still weak, limited absorption; more downside risk
- Vacancy rates peaking, rents stabilizing but low
- Absorption flat, recovery lagging tenants nagging

## 2012 Spatial Market

- Spotty correction, plateau in connection, deferred resurrection
- Vacancy peaking, rents creaking
- Modest absorption, tenant reflection, landlord perplexion

## 2012 Spatial Market

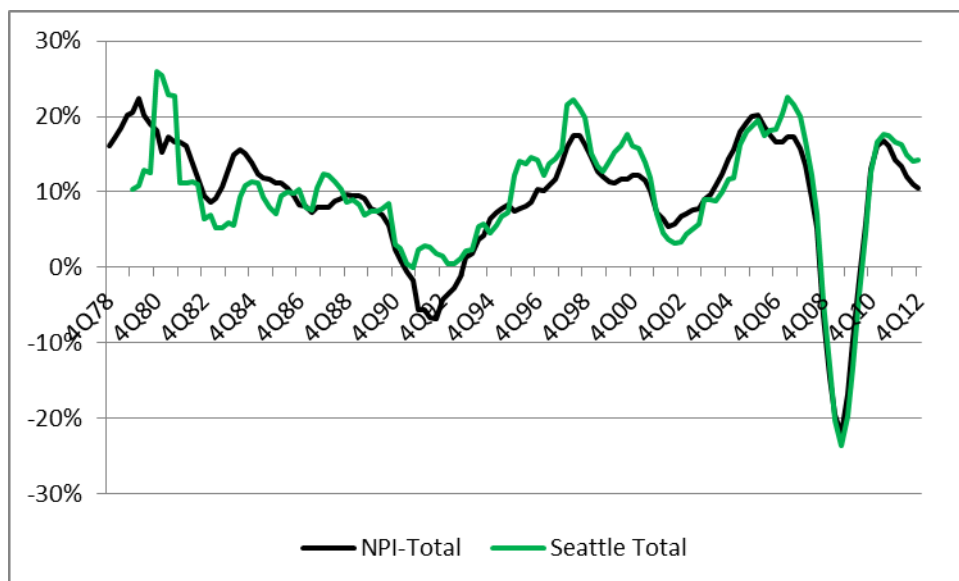
- Moderate improvement, users content, producers lament
- Vacancy slipping, rents holding
- Some uptake, tenant reflection, developer conviction

# Seattle: NCREIF Investments 4Q2012

	Props	Years	Market Value (\$ millions)		
WA - Seattle	269	27.75	11,672.7	Total:	14.29
				Appreciation:	8.35
				Income:	5.60

WA - Seattle Apartment	51	11.75	2,484.5	Total:	16.25
				Appreciation:	10.63
				Income:	5.21
WA - Seattle Apartment-Garden	24	7.50	1,064.3	Total:	13.16
				Appreciation:	7.54
				Income:	5.32

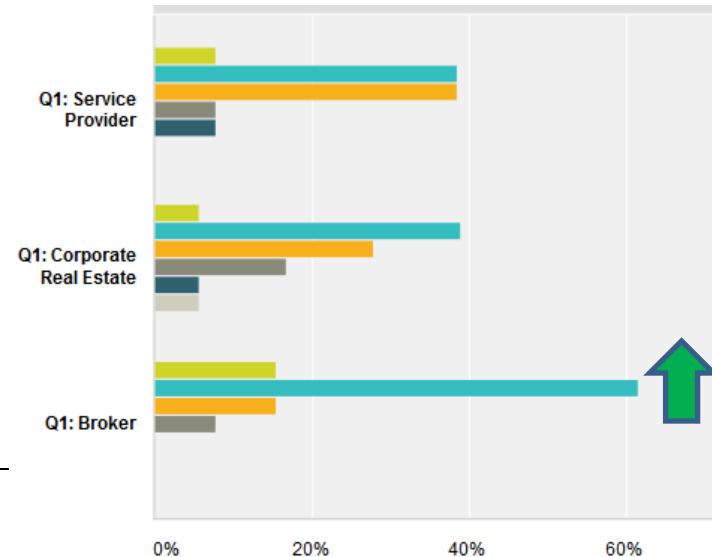
	Props	Years	Market Value (\$ millions)		
WA - Seattle Industrial	115	23.75	2,084.8	Total:	14.46
				Appreciation:	8.19
				Income:	5.91
WA - Seattle Industrial-Warehouse	98	14.50	1,663.0	Total:	17.04
				Appreciation:	10.84
				Income:	5.75
WA - Seattle Office	70	13.00	5,098.5	Total:	12.03
				Appreciation:	6.36
				Income:	5.42
WA - Seattle Office-CBD	32	5.25	3,214.4	Total:	12.67
				Appreciation:	7.82
				Income:	4.59
WA - Seattle Office-Suburban	38	8.50	1,884.1	Total:	11.04
				Appreciation:	4.14
				Income:	6.69
WA - Seattle Retail	30	4.50	1,865.1	Total:	17.02
				Appreciation:	10.39
				Income:	6.16



# Seattle Transaction Volume and Pricing

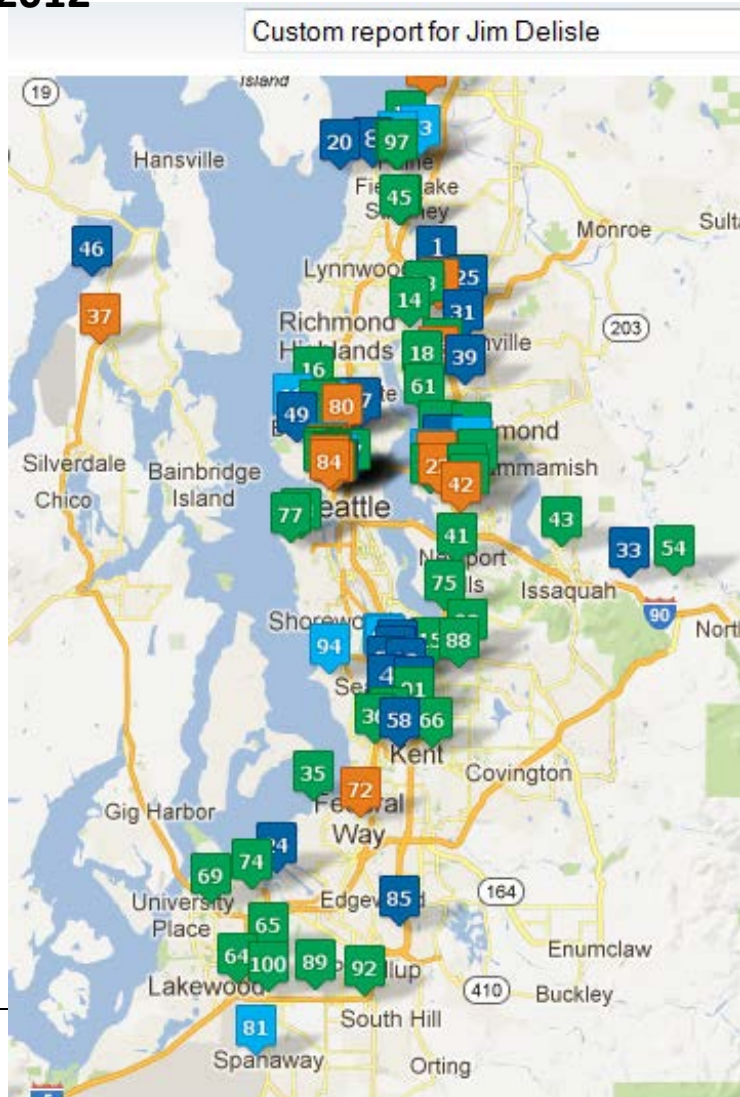
RCA Top Markets Export - Created on 01/14/2013		
All Property Types - United States		
Market	Volume (in \$mil)	Cap Rate
NYC Metro	41,637	5.86%
LA Metro	26,559	6.27%
SF Metro	21,858	5.78%
DC Metro	19,202	6.24%
Chicago	11,359	7.00%
Seattle	10,334	5.71%
Houston	8,749	7.38%
Dallas	8,137	7.29%
So Fla	8,133	6.94%
Boston	7,771	6.98%
Atlanta	6,934	7.09%
Phoenix	6,155	5.99%
Denver	5,773	6.79%
San Diego	4,853	6.45%
Austin	4,214	6.83%

**Investors Pour (poor?)  
more \$'s into Seattle**

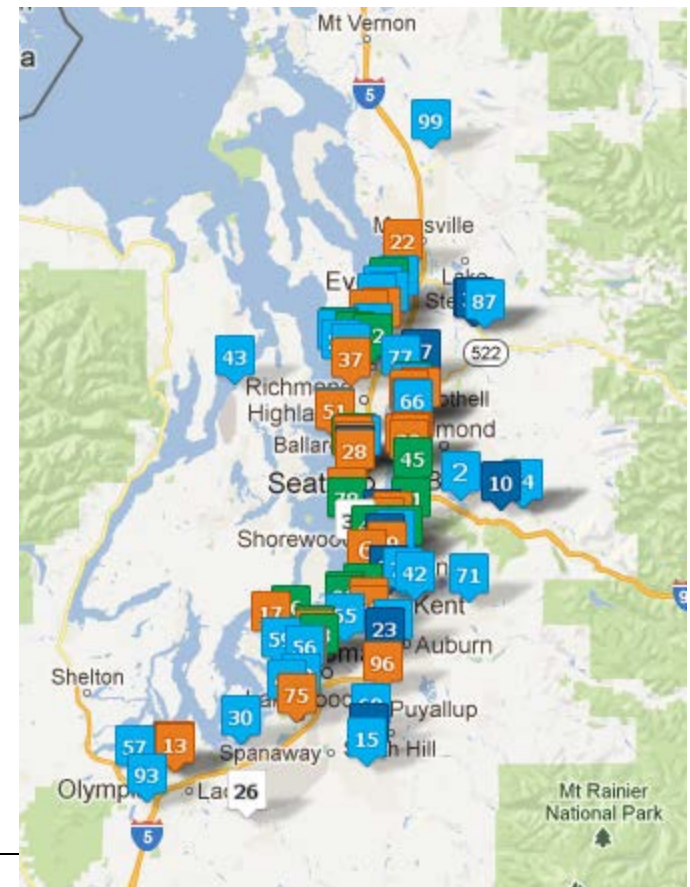


# Seattle Transactions and Distressed Assets

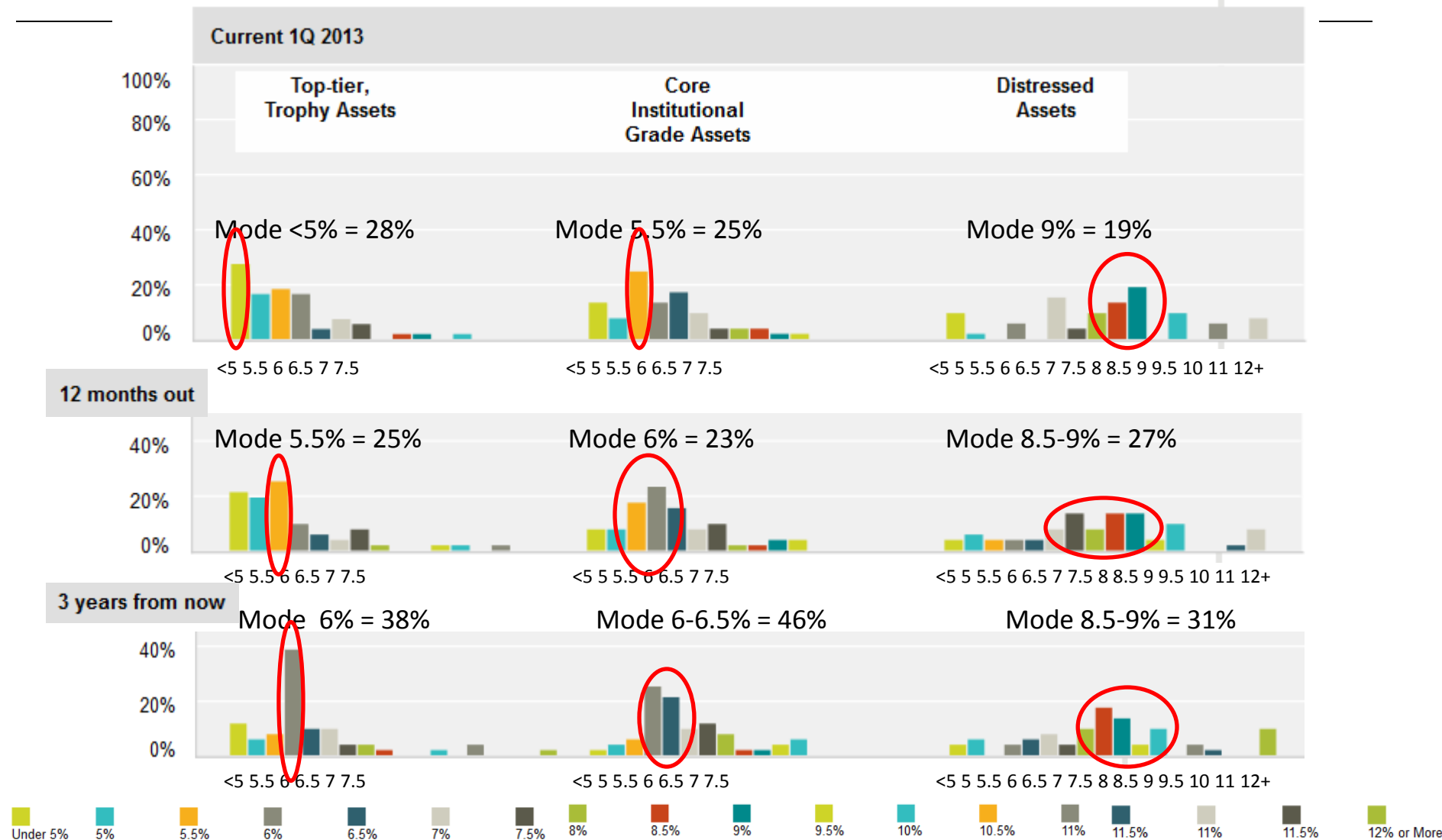
## Transactions 2012



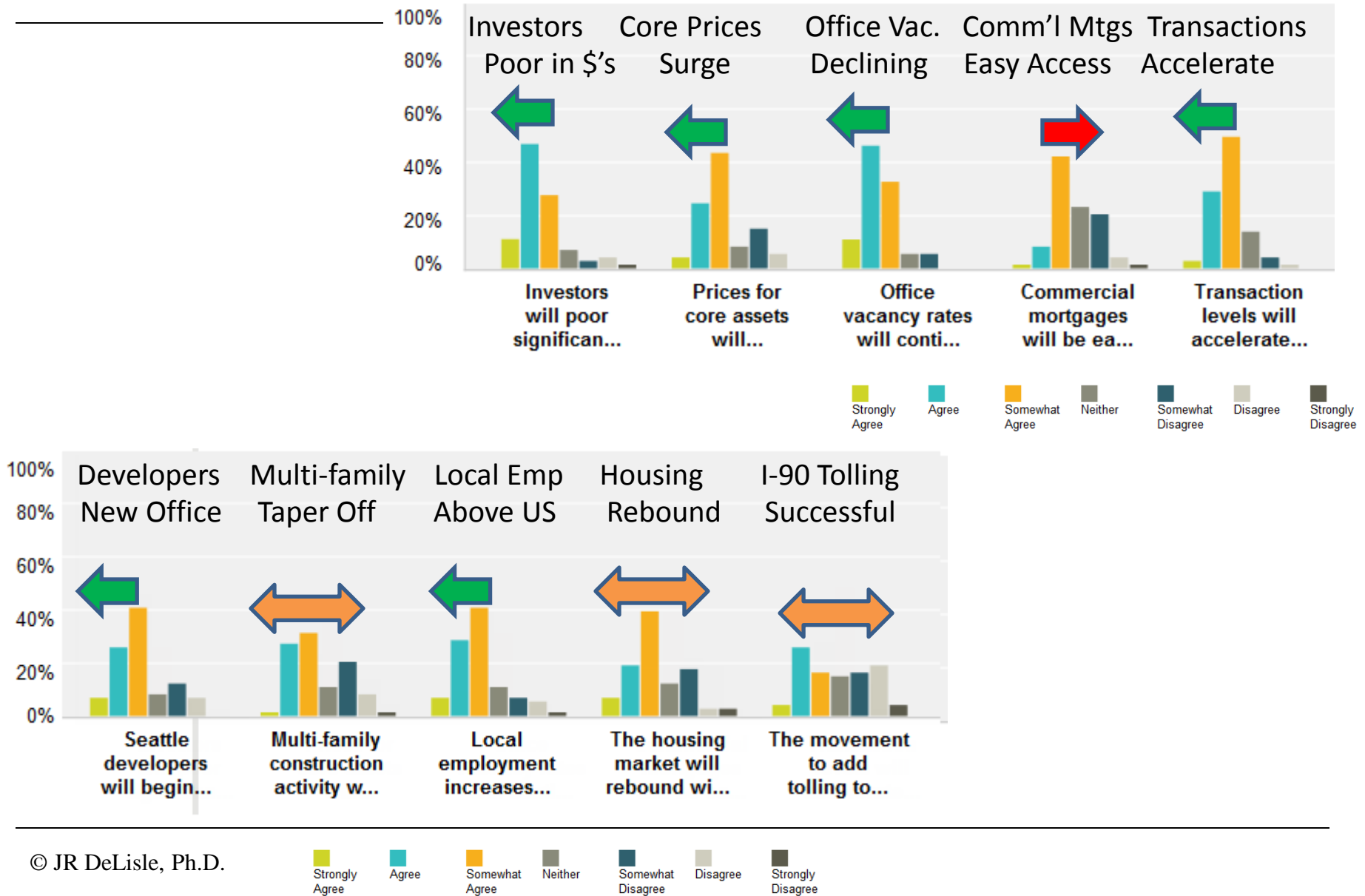
## Top 100 Distressed 2012



# Seattle Cap Rates: 2013, 2014 and 2016



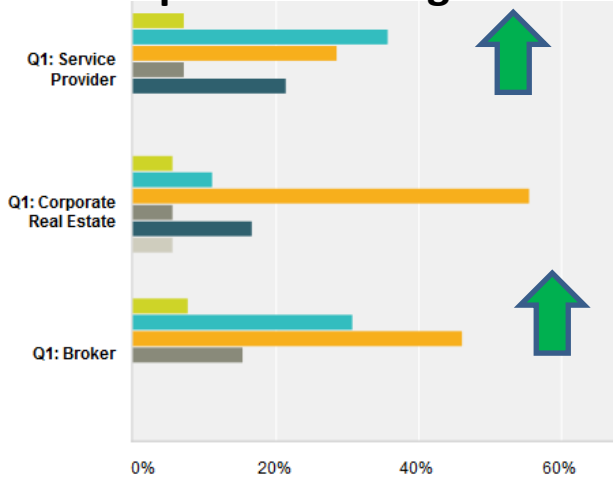
# Seattle Market Outlook: Agree/Disagree







## Development Coming

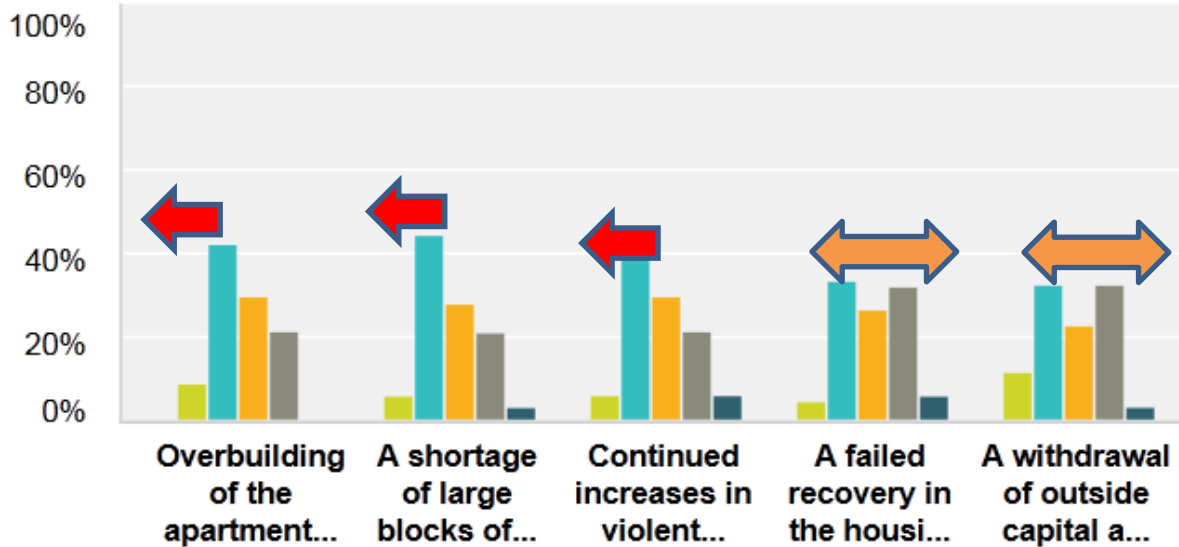


## Biggest 2012 Surprises

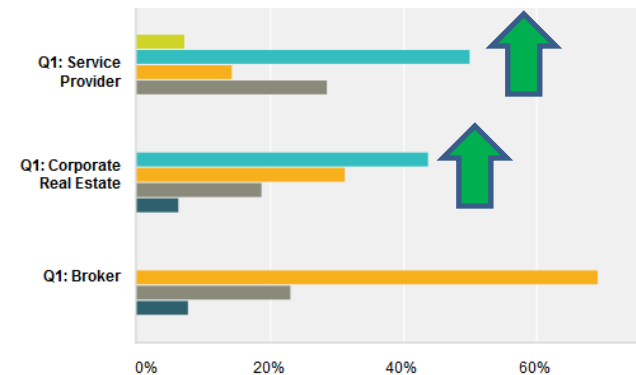




# Significance of Risks to Seattle Economy in 2013



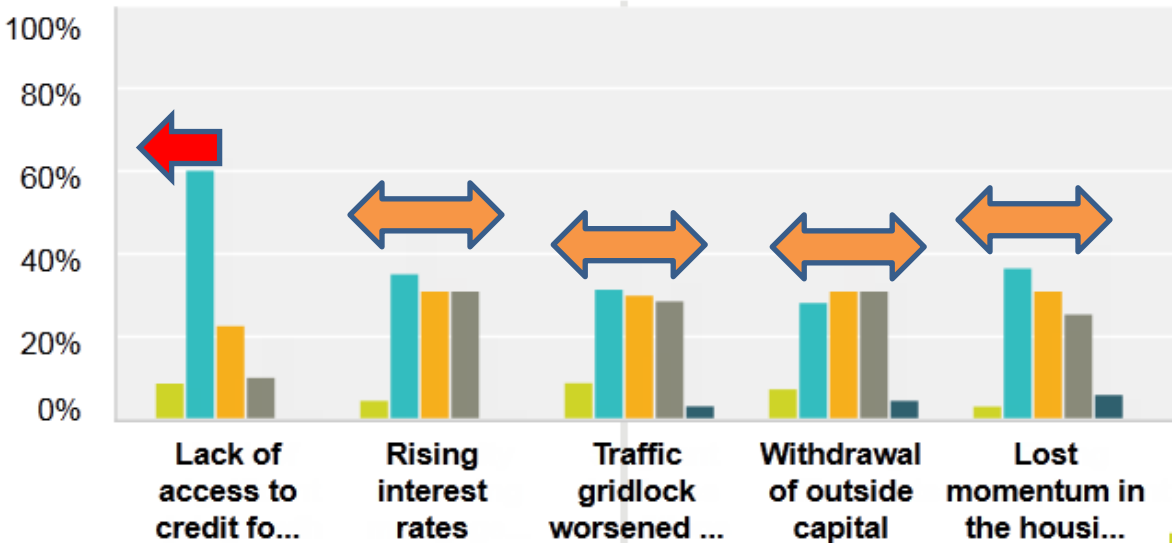
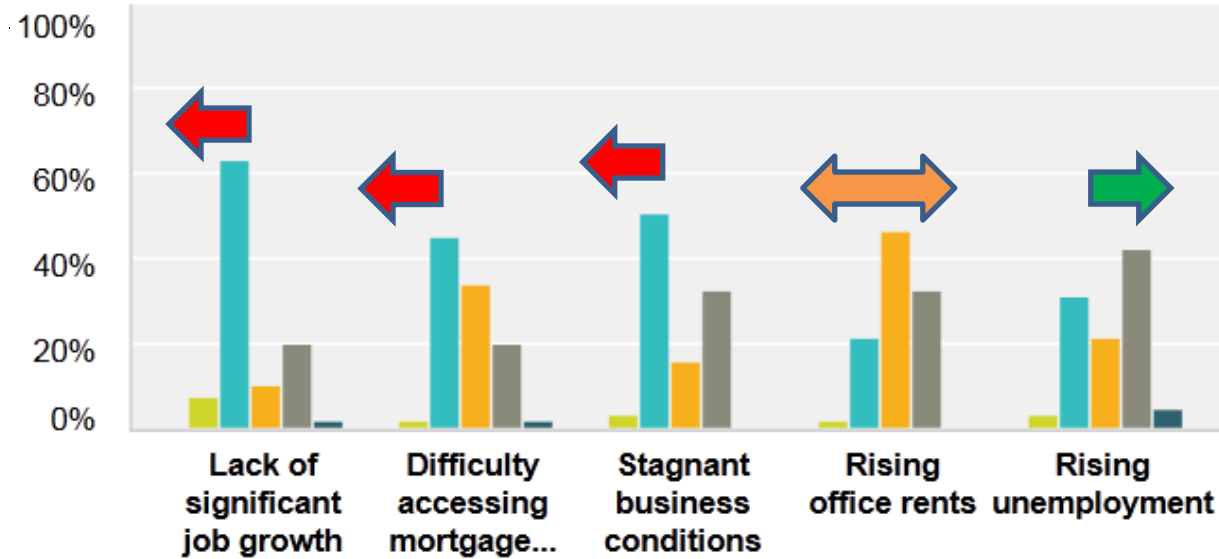
## Lack of Affordable Housing vs. Top End



## Shortage of Big Blocks of Office



# Top Issues and Risks in Seattle Real Estate Market



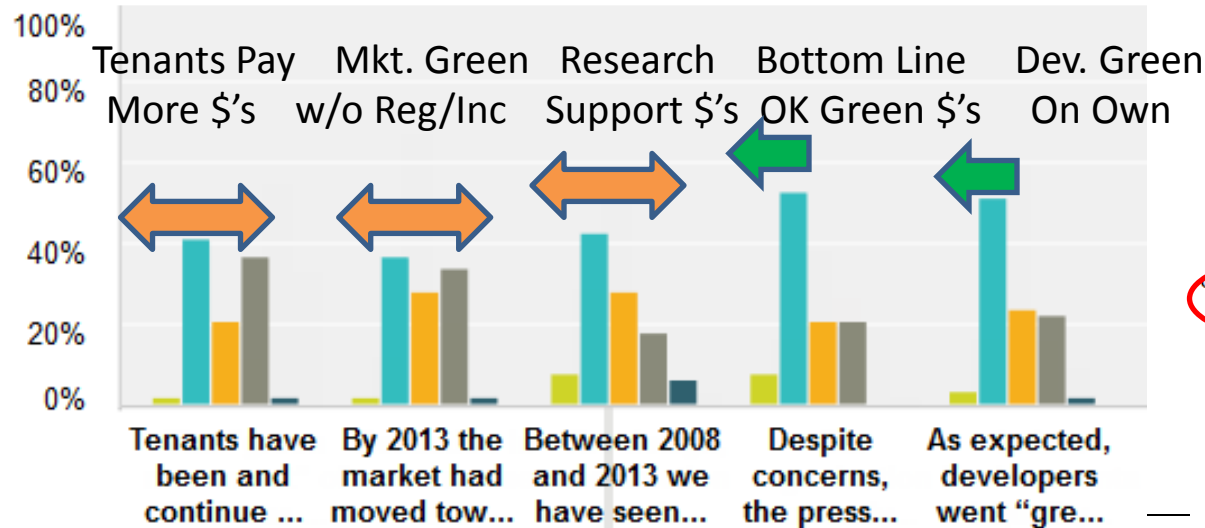
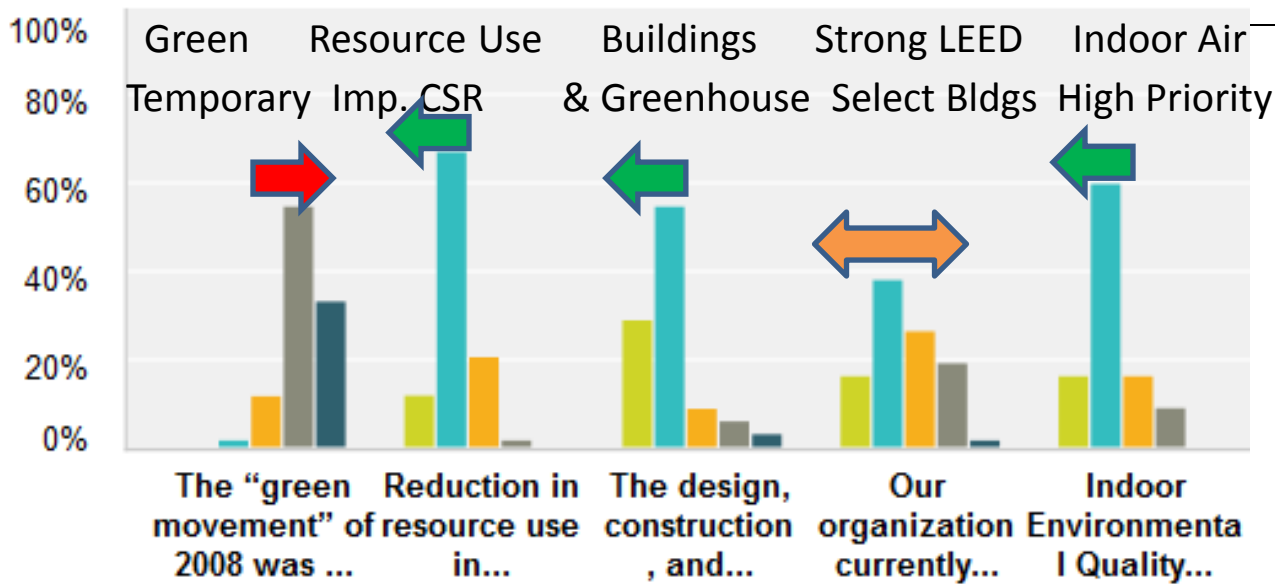
# How Will Industry Change Over 3-5 Years?

- Development
  - Possible spec development
  - LEED becoming ubiquitous
- Demand
  - Shorter lease terms, less space
  - Significant changes: flex and short term needs
  - Technology driving
  - Quality properties will remain in demand
- Players
  - Fewer larger players Fewer people working in it
  - Fewer local, niche players

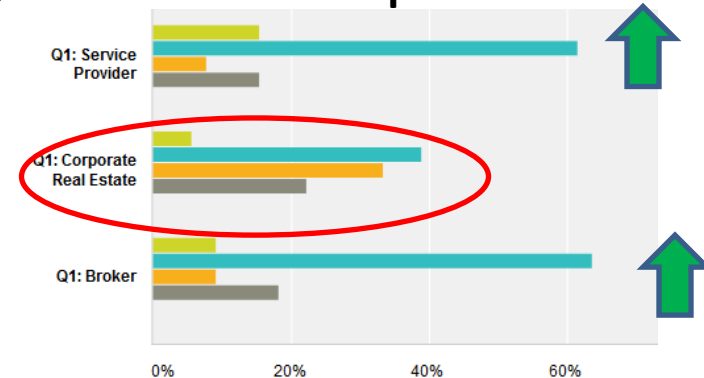


Commercial Construction Continued  
Development Important Interest Rates  
Job Growth Market Second Space Square Footage  
Technology Values

# Green Building Movement: CoreNet 2008-2013



## Bottom Line Pressure not Stop Green



# What Are the Greatest Opportunities in Seattle?

- Value Creation
  - Distressed real estate; true value-add
  - Existing property Upgrades
  - Buying below top
  - Back fill and subsequent sale
  - Buying distressed properties
- Demand
  - Continued growth in the intellectual business segment
  - Beyond Amazon: emergence of new technology companies
  - Affordable housing; too much top end
- Development
  - Waterfront
  - Transportation related projects
  - SoDo
  - Core Seattle/Bellevue Class A

[illegible]

Amazon Buying Development Distressed  
Existing Groups Growth Housing Office  
Buildings Repositioning SoDo Space  
Waterfront

# What is Biggest Change Coming to Seattle?

---

- Changing Fundamentals
  - Multifamily oversupply; lack of supply in the office sector
  - Continuing drag on the market of residential
  - More consolidation, fewer players, tough on small developer
- Economy
  - Rediscovery of domestic production capabilities and competitiveness
  - Significant changes in US economic drivers; intellectual development/trade,
- Demand
  - Non-traditional office environments ( hotelling and telecommuting and clicks and bricks retail)
  - Shrinking demand ;improved occupancy management
  - Corporations shedding real estate. “r
- Transactions/Values
  - Buyers and sellers agreeing on price
  - Lenders able to lend on non-core ass
  - Energy monitoring, regulation



- Operations
  - Cutting costs while satisfying demand
  - Maintaining competitive advantage
  - Increase spending in spite of bottom line pressure
- Future Planning
  - Forecasting corporate needs
  - Making bets in the face of uncertainty
  - Earning respect, internal clients & management
  - Rightsizing in face of downsizing pressure
- Portfolios
  - Gauging portfolio level demand
  - Maintaining strategic focus under pressure, uncertainty
  - Measuring value-add, attribution



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# Presentation Summary

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- Part I: Economic Outlook
- Part II: Real Estate Capital Markets
- Part III: Real Estate Market Fundamentals
- Part IV: Challenges, Issues & Opportunities

## Knowledge Business: Creation and Transfer



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