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## Comment

### The shoe has dropped

*It has been repeatedly said that commercial real estate will be the next shoe to drop in the US. But thanks to a lack of transactions and a wall of uninvested equity, speculation is mounting that it has already happened. By Zoe Hughes*

Anyone thinking they could be patient in waiting to take advantage of the distressed opportunity of a lifetime would have had a shock had they attended the Urban Land Institute's spring conference in Boston this week.

Not only would they have learned those deals were largely not making it to market, as the industry had originally envisioned, but whenever transactions did emerge competition was intense.

Indeed, there is currently such a mismatch between the supply of property and the demand from equity investors targeting the US that one real estate economist predicted cap rates in the US had already reached their peak and were now starting to compress back to levels seen in 2005 and 2006 – and even back to the lows last seen in 2007.

Unlike the RTC crisis in the early 1990s, banks and financial institutions have been refusing to offload troubled estate mortgage and assets at fire sale prices. Instead they have focused on restructuring and reworking a loan, rather than foreclosing on it – leaving many property market shelves bare.

However, at the same time a wall of capital – both domestic and foreign – has emerged at the sidelines of the US property markets in search of opportunities at distressed prices. At ULI this wall of equity was estimated to be roughly \$150 billion, including \$45 billion sat in private equity real estate opportunity and value-added funds. With modest leverage, that figure rises to between \$250 billion and \$350 billion of firepower targeted at the US, and predominately its major cities.

As such any deals that do make it to market are inundated with bids, with many professionals now arguing pricing has become too "aggressive". What has proved surprising – and shocking – for many of the 3,000 delegates gathered in Boston though is the speed of this value recovery. One national broker told a ULI panel Thursday that cap rates had declined by more than 100 basis points in the past six months alone – because of the amount of equity chasing deals. In the last 90 days in particular, the speed of cap rate compression had been "astounding" and "shocking", two other real estate professionals added.

This week's acquisition of 600 Lexington Avenue in New York by REIT SL Green from Hines was just one deal being closely watched by the industry amid speculation a price bubble is starting to grip the city. Hines had originally bought the property on behalf of its US Core Office Fund for \$91.6 million or \$329-a-square-foot in 2004. On Thursday, SL Green revealed it paid \$193 million for the property – or roughly \$636 per square foot – including the assumption of a \$49.9 million interest-only loan.

Fears of a bubble though aren't just restricted to core assets in New York or Washington DC, the US' top two markets. ULI heard numerous reports of aggressive bidding for vacant properties in California, for non-performing loans and even land across the US.

The situation prompted some ULI delegates to wonder this week whether the boom was back. As one workout specialist retorted: "If commercial real estate is the next shoe to drop in the US, then it's already dropped. People just didn't hear it."