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FW: Bloomberg on commercial real estate

Commercial Real Estate in U.S. Poised for Price Drop

By Hui-yong Yu and David M. Levitt

Sept. 5 (Bloomberg) -- U.S. commercial real estate prices may fall as much as 15 percent over the next year in the broadest decline since the 2001 recession as rising borrowing costs force property owners to accept less or postpone sales.

"People aren't willing to do deals right now," said Howard Michaels, the New York-based chairman of Carlton Advisory Services Inc., which has arranged financing for real estate purchases including the Lipstick Building in midtown Manhattan. "The expectation is that prices will come down."

Investors in July bought the fewest commercial properties since August 2006 and apartment building acquisitions were down 50 percent from June, data compiled by industry consultants at New York-based Real Capital Analytics Inc. show. Archstone-Smith Trust in August postponed its \$13.5 billion sale to a group led by Tishman Speyer Properties LP until October. Mission West Properties Inc., the owner of commercial buildings in Silicon Valley, said on Aug. 13 that the company's \$1.8 billion sale may fail after a bank withdrew funding.

"There are so many deals falling apart," said David Lichtenstein, chief executive officer of Lakewood, New Jersey-based Lightstone Group, an owner of more than 20,000 apartments and 30 million square feet of office and retail space. "People who can get out are getting out."

Higher Costs

About 930 commercial real estate transactions valued at \$5 million or more closed in July, preliminary data from Real Capital show. That count could climb as much as 15 percent when all of the month's deals are tallied, which would still be the lowest this year, said Dan Fasulo, director of market analysis for Real Capital.

Average prices for commercial properties might drop 5 percent to 15 percent in the next two years depending on the type of property and its quality and location, said Matthew Ostrower, an industry analyst at New York-based Morgan Stanley, the second-largest U.S. securities firm by market value.

Michael Knott, a senior analyst at Green Street Advisors Inc., a real estate research firm in Newport Beach, California, estimates commercial prices may fall about 10 percent in the next 12 to 18 months and up to 15 percent in the office market during that period.

Shares Fall

The Bloomberg Office Property Index fell as much as 2.7 percent, led by SL Green Realty Corp., Manhattan's largest office landlord. Commercial real estate brokers and managers declined. CB Richard Ellis Group Inc., the biggest commercial broker, dropped as much as 9.7 percent. Jones Lang LaSalle Inc., the second-largest, fell as much as 3.5 percent.

Commercial mortgage rates have climbed as defaults rose in the subprime part of the residential real estate market. About six months ago, a 30-year commercial loan with 5 to 10 years of interest-only payments would have cost the borrower about 120 basis points more than the yield of the 10-year Treasury note. A similar loan would now cost about 160 to 200 basis points more than the 10-year Treasury's yield of 4.6 percent, data compiled by New York-based Cushman & Wakefield Sonnenblick Goldman show.

The increase has halted a rally that lifted prices for office buildings, apartments and hotels to records this year. The average price paid for high-quality office properties in city centers reached \$291 a square foot, up from \$188 in 2005 and almost double the average \$152 in 2001, Real Capital reported.

Capitalization Rates

Real estate investors typically purchase properties with the expectation that the yield will outstrip conventional investments and make their financing affordable.

When prices for prime urban office buildings fell in 2002, capitalization rates, or a property's net operating income divided by the purchase price, rose to an average 9.25 percent, according to Chicago-based data provider Real Estate Research Corp.

That was almost 500 basis points more than the average rate of 10-year Treasury bonds at the time. Such yields attracted investors and by this year's first quarter, the average cap rate had fallen to 6.5 percent.

New York-based Blackstone Group LP, manager of the world's largest buyout fund, purchased Sam Zell's Equity Office Properties Trust for \$23 billion in February to gain about 540 office buildings in the U.S. That worked out to a capitalization rate of about 5.3 percent, a record low for an acquisition of a real estate investment trust, according to Green Street Advisors. Including debt, the price was \$39 billion.

'Fear in the System'

Regency Centers Corp. lost an equity partner in May for the \$80 million purchase of four shopping centers in Florida because financing costs exceeded the projected cash flow, said CEO Martin "Hap" Stein in an interview. Jacksonville, Florida-based Regency is the third-largest company by market value in the Bloomberg REIT Shopping Center index.

"You've got a lot of fear in the system from the capital markets," Stein said. "As far as the pricing of credit, it was greed six months

ago and it's fear today."

Tighter credit standards at banks has given an advantage to investors with ample cash, said Joaquin de Monet, CEO of General Electric Co.'s Arden Realty Inc. All-cash buyers might include insurance companies, pension funds and REITs.

Cash Rules

Los Angeles-based Arden bought 5.9 million square feet of offices from Blackstone in July. The properties, part of CarrAmerica Realty Corp. when Blackstone acquired it last year, were in San Diego, San Francisco and Orange County, California; Portland, Oregon; Salt Lake City, Utah; and Seattle.

"The private equity firms used to be the winners, but now lower leveraged and all-cash buyers are more competitive," de Monet said in an interview.

Even so, sellers are pulling properties from the market, said James Corl, chief investment officer for real estate securities at New York-based Cohen & Steers Inc., which manages almost \$35 billion for clients.

"No one's going to want to sell in this environment, because you're not going to get your price," Corl said.

The Bloomberg Office Property Index of real estate investment trusts has dropped 24 percent since reaching a record high on Feb. 8, just as Zell sold his company to Blackstone in the largest real estate takeover. The index had dropped 27 percent through Aug. 30 before stocks rallied the next day after President George W. Bush and Federal Reserve Chairman Ben Bernanke pledged to prevent credit losses from snuffing out the country's economic expansion.

Macklowe's Towers

The slump has ensnared New York developer Harry Macklowe, who may have to sell assets to pay back \$3.4 billion of short-term debt. Macklowe bought seven Manhattan office towers from Equity Office in February for \$6.7 billion concurrent with Blackstone's takeover of Zell's Equity Office.

"The mortgage market has changed," said William Macklowe, Harry's son and president of Macklowe Properties Inc., in an interview. "We're in advanced discussions with several groups to refinance the purchase, to achieve several outcomes with respect to the portfolio." These might include an equity infusion or asset sales, he said.

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