

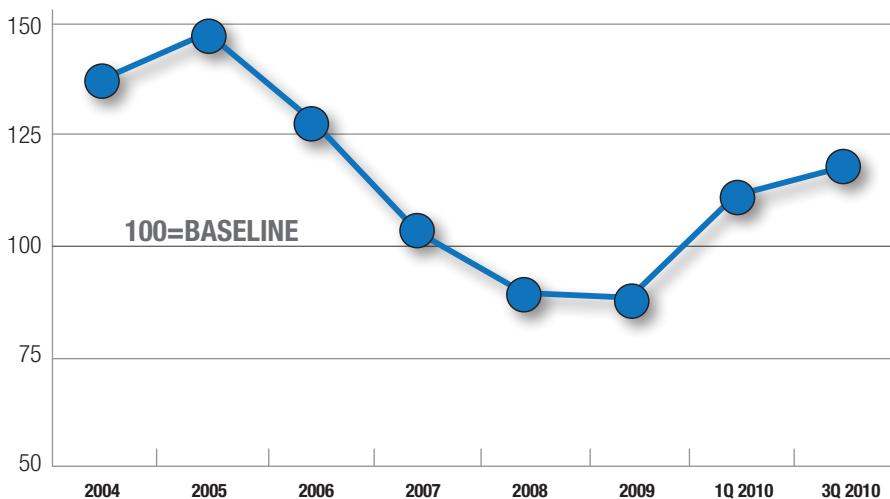
Investors Go On Offense

Improving capital markets spark renewed interest across property types.

FIGURE 1. INVESTOR SENTIMENT CONTINUES UPWARD TREND

The exclusive National Real Estate Investor/Marcus & Millichap Investor Sentiment Index shows that investor confidence has taken a major step forward in the past year. After bottoming out in 2009 with an index rating of 91, investor sentiment rose to 113 in the first quarter and 119 in the third quarter of this year. Although the index shows that sentiment is still well off the high of 148 that occurred in 2005, the positive trend over the past year is an encouraging sign that investor confidence is returning.

The index takes into account survey responses related to expected changes in property values for various real estate sectors, as well as plans to increase or decrease total real estate holdings. The baseline of 100 indicates neutral sentiment for the industry. The trajectory shows that investor sentiment reached its high in 2005, followed by a dip to a trough in 2008 and 2009, and is now showing signs of an upswing in 2010.



Growing confidence in apartments, hotels and even the downtrodden retail sector is helping pull investors off the bench and back into the game. Some 55% of all respondents to a survey conducted by National Real Estate Investor and Marcus & Millichap Real Estate Investment Services believe that now is the time to buy apartments, followed by retail (32%), undeveloped land (29%), hotel and mixed use (26%), and office and industrial (24%).

That enthusiasm is even strong among investors who already own apartment properties, with 70% indicating that now is the time to buy [Figure 2]. Conversely, only 36% of office owners believe now is the time to buy office properties. Apartment owners also are bullish on rents, with 41% anticipating that rents will increase over the next 12 months.

The response to the online survey conducted between July 15 and July 30 — which yielded 529 responses — shows a big boost in confidence compared with a similar survey conducted in the fourth quarter of 2009. Back then, 31% of apartment investors projected an increase in effective rents, and the projected increase averaged a miniscule 0.2%.

“There is no question that apartments really scream when it comes to actual performance and renewed investor confidence,” says Hessem Nadji, managing director of research and advisory services at Encino,

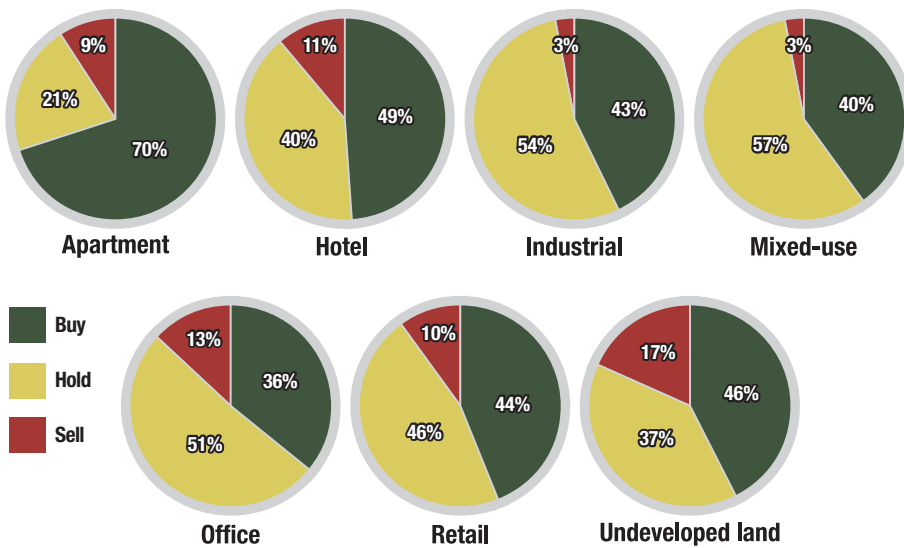
Survey Methodology

In mid-March, National Real Estate Investor’s research unit and Marcus & Millichap e-mailed invitations to participate in an online survey to public and private investors and developers of commercial real estate. Specifically studied were Marcus & Millichap clients and subscribers of NREI and Retail Traffic selected from commercial real estate investor, pension fund, and developer business subscribers who provided their e-mail addresses. The majority of respondents are private investors (36%); private partnerships (19%) or developers (16%) with an average of \$35.8 million invested in commercial real estate. Real estate investment trusts and institutional investors represent 6% of all respondents.

FIGURE 2. INVESTOR PERCEPTION OF PROPERTY TYPES

In your view, is now the time to buy, hold or sell each of the following property types?

Percentages reflect only the opinions of respondents invested in each property type



Calif.-based Marcus & Millichap.

Apartments are identified as the best product to buy right now because the property sector is leading the recovery in real estate fundamentals. Nationally, apartment vacancies declined 20 basis points during the first half to reach 7.8%, setting the stage for rent growth of 3% for 2010, according to Marcus & Millichap.

Hotel owners also are exhibiting a surge in confidence, with 39% of respondents projecting a rise in the average daily rate (ADR) in the coming year compared with 34% who expect rates to remain the same, and 25% who predict a decline.

That is a noticeable improvement over fourth-quarter 2009 sentiment when only 7% of hotel owners anticipated an increase, 31% thought ADR would remain the same, and 59% expected a decrease in rates. Hotel owners who predict an increase in ADR in the coming year expect an average rise of 6.4%.

“Those two sectors are far more correlated with the general economy on a more

immediate basis because of their short-term leases,” says Nadji. Hotels can change room rates daily, while apartments typically operate with 12-month leases.

Sales activity improves

Although transaction volume is far below normal levels, property sales have increased significantly in the past year. Nearly \$36.4 billion in commercial real estate properties traded hands during the first half of 2010. That marks a 40% rise over the \$21.7 billion in sales in the first half of 2009. Still, that sum pales by comparison to the \$89 billion notched in the first half of 2008.

The volume of property sales during the first half of 2010 met the expectations of more than half of investors (58%). A closer look at the results shows 20% believe that sales met expectations, 20% think sales met expectations and should continue to improve, and 18% say that sales met expectations but that it’s an anomaly.

“It is a little concerning that as much as 18% think that the improvement in

sales is temporary and isn’t going to last,” says Nadji. That is a high number, and it is even more worrisome when combined with the 39% who indicate that property sales over the past six months did not meet expectations.

However, that response stems in part from the continued frustration and disappointment in the market over the limited volume of quality properties available for sale and distressed sales, adds Nadji.

On a positive note, the financing spigot is beginning to open up again. One in three respondents (34%) believes that institutional lenders have experienced the biggest improvement in lending volume, followed by commercial banks (28%), and government agencies such as the Federal Housing Authority (19%).

“Financing is beginning to thaw, but it is nowhere near where it needs to be to support normalized sales volume,” emphasizes Nadji.

“It is encouraging to see insurance companies and CMBS come back into the market and we expect them to play a bigger role in 2011,” says Bill Hughes, senior vice president and managing director of Marcus & Millichap Capital Corp.

Buyers still skittish

The positive investor sentiment that emerged in the first quarter has held its own despite some major bumps on the road to recovery, including the European debt crisis and slower than expected job growth in the United States.

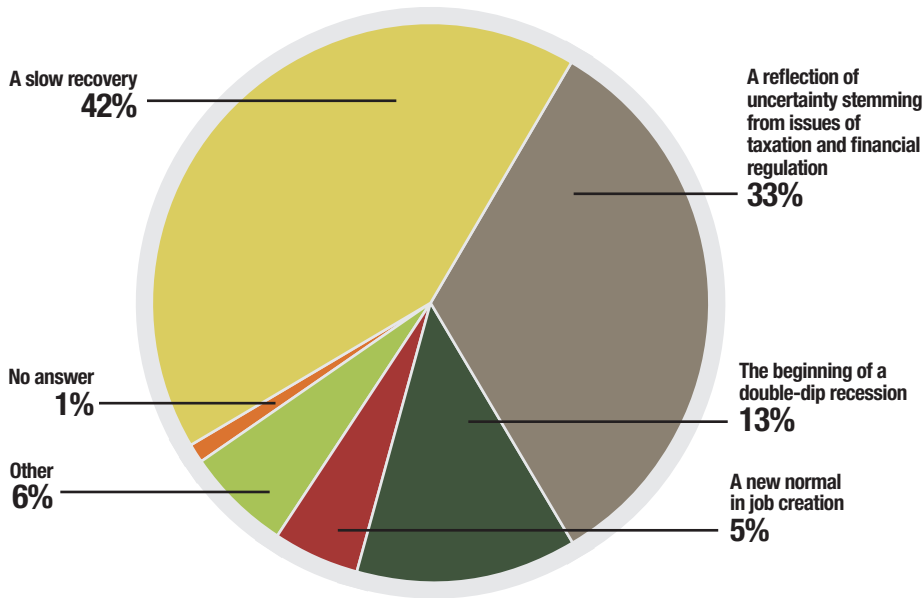
The majority of respondents (61%) plan to increase their commercial real estate investment in the next 12 months. That sentiment is much the same as the first-quarter survey results when 60% of investors said they planned to expand their holdings.

Respondents have an average of \$37.4 million invested in real estate, and respondents who do expect to grow their commercial real estate portfolios anticipate an average increase of 23%.

Although the industry still has a long recovery ahead, the NREI/Marcus & Milli-

FIGURE 3. PERCEPTION OF RECENT JOB GROWTH

The private sector added an average of just under 100,000 jobs per month in the first half of 2010. Do you believe this is a reflection of:



Base: respondents to the 3Q 2010 survey, 529

chap Investor Sentiment Index also supports the fact that investor confidence has taken a major step forward in the past year.

After reaching a low point of 91 in 2009, the index has been steadily on the rise but remains below the peak of 148 set in 2005. By the third quarter of this year, the index had rebounded to 119. Since 2004, NREI and Marcus & Millichap have been tracking investor plans for changing their commercial real estate holdings, as well as expectations for changes in property values. This information has been compiled to produce the investor sentiment index shown on page 1.

“There is a strong response of investors who want to buy more real estate,” says Nadji. “But we also are stuck in this period of uncertainty and cautiousness.” The

European debt crisis shook a fragile global economy and sparked fears that turmoil in Europe may infect the U.S.

Virtually all respondents (96%) expect the European debt crisis to have at least some impact on the U.S. economic recovery. On a scale from 0 to 5 with 5 representing the highest impact, the vast majority (76%) rate the impact as a 3, 4 or 5. Only 20% of respondents rate it as a slight impact at a 2, and 4% report no impact or did not answer the question.

Results of the European bank stress tests were announced July 23. The tests, which were conducted by the Committee of European Banking Supervisors, showed that the majority of banks are on solid footing. Although some critics say that the tests

were not strict enough, only seven of the 91 European Banks tested failed the stress test.

“There is an overstated jitteriness in the marketplace, and I think investors are astute to consider the European debt crisis as a problem because it does affect U.S. exports. And exports are a significant contributor to gross domestic product,” says Bill Hughes, senior vice president and managing director of Marcus & Millichap Capital Corp.

The gross domestic product rose 2.4% on an annualized basis in the second quarter, much slower than the 3.7% growth rate achieved during the first quarter.

Obstacles remain

One of the key stumbling blocks to recovery has been the weak job growth. The private sector added an average of slightly fewer than 100,000 jobs per month during the first half of 2010. In comparison, the U.S. added an average of 186,600 jobs per month during the first half of 2006.

The largest group of respondents (42%) believes that the relatively slow pace of job growth is a reflection of a sluggish recovery, while 33% believe it is a reflection of uncertainty stemming from issues of taxation and financial regulation [Figure 3].

Another 13% of respondents believe the weak job market is the beginning of a double-dip recession, 5% believe it is a new normal in job creation, and the remaining 7% either had no answer or a different response altogether.

“This economy is clearly slowing and we cannot ignore our long-term issues,” says Nadji. “Once we get past the exaggerated concerns regarding a double dip, and there is more clarity about the direction of the economy, I expect both investor sentiment and sales activity to increase substantially. I think that will happen by the end of the first quarter in 2011.” ■