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Legal Insights

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Real Estate Market Update

I've just returned from the annual Spring Meeting of Zell-Lurie Real Estate Center at the Wharton School. The conference annually assembles an all-star cast of real industry moguls and university professors to discuss the state of the real estate economy. This year's conference included the President of Boston Properties, the President of Host Hotels & Resorts , the CEO of Eastdil Secured, the CEO of Brookfield Property Group, the Group Head of Wells Fargo Commercial Real Estate, and the final panel included Barry Sternlicht, CEO of Starwood Capital and Michael Fascitelli, the retired CEO of Vornado Realty Trust.

This was truly a view from the top and I would say that the consensus was that the view was generally good. The focus of these panelists was primarily on office buildings, hotels, and office warehouse and they all felt those segments had recovered nicely from the downturn and were continuing in the right direction. There, of course, were significant caveats. First, was the uncertainly of interest rates. Everyone agreed interest rates would go up (subject to Bernanke's assurances that they would stay low through the middle of 2015), but they also agreed that they had no idea when, how much, and how quickly rates would ultimately move. They felt there was really no precedent that allowed them to anticipate how the Fed would act when it was ready to allow interest rates to move. Next on the list of challenges was the political situation in Washington. Specifically, recognition that the business community and, therefore, the economy needed Congress to make some headway on tackling the deficit. Employment also remained a major concern. While the economy was creating jobs at a reasonable rate and in fact, overall employment could reach pre-recession levels by mid-2014, they recognized that real unemployment was much higher than the reported unemployment rate and that the unemployment rate for high school dropouts, who constitute a significant part of the country's workforce, remains exceptionally high. They also pointed out the budget problems at the state and local levels and how that would continue to be a drag on the economy. Notwithstanding these issues and what they described as the most challenging investment environment in their careers, they were clearly pleased with where their businesses were right now.

Keep in mind, however, this was a "view from the top." Most, if not all, of these companies have the luxury of only investing in the best real estate in the best markets and have the advantage of access to massive amounts of

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equity and debt. They readily acknowledged that there is tremendous market and regional differentiation. Regions with high human capital, i.e. highly educated work forces, were thriving, while other markets were struggling. Office buildings in top tier cities were thriving, while second tier city and suburban office continues to be challenged. There was little discussion of retail other than in the context of increasing sales in the best malls in the best markets. These companies were not heavily invested in multi-family, although they were concerned that multi-family was becoming over-built.

My takeaway from the conference is that there is a meaningful distance between the type of real estate these companies are chasing and the vast majority of commercial real estate in the rest of the industry. Hopefully, many of the elements that are making their premier real estate prosper are also applicable the balance of the industry, but I suspect that the panelists' caveats probably disproportionately affect that balance.

The good news is that a few years ago even the "view from the top" was a scary one. While their rosy view may not yet translate to the less fortunate portions of the real estate industry, it does reflect a positive direction that, barring one of the many possible hiccups, should bode well for the future.