



**2011 BDI Seminar --- May 6, 2011**

**“Back to School: Resetting Your Community’s 3 R’s (Retail, Restaurants, Residential)”**

**“Changing Economics Affect on Municipal Policy Decisions and Urban Design”**

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### **Housing**

- Return to traditional financing which requires reasonable down payments and income to loan ratios at realistic interest rates. Many consumers are removed from the marketplace for the foreseeable future.
- It is probable that existing interest rates will rise.
- New (traditional) financing in concert with a 2-4 year home inventory will continue to depress prices.
- Rapidly increasing rental occupancy rates and rental price per square foot rates.
- Strong buyer preferences for rental based upon affordability and mobility.
- Huge housing inventories may not be possible to “dump” by the lenders.
- Lenders and REO buyers may become key landlords for both multi-family and single family units.
- Potential tax code changes may dilute the financial advantage of home ownership.
- New construction pricing must be tailored to new market realities not old labor costs.
- Smaller new construction units based upon affordability.
- Creative parking solutions to avoid significant covered parking costs.
- Continued emphasis on age restricted new construction.
- Ongoing role of tax credits in new construction.

### **Office**

- Significant inventory remains to be absorbed.
- Competitive rental rates do not support existing loan values.
- Significant market for REO buyers.
- New construction (if any) will be focused on the signature tenant.
- Buyers market suggests continued tenant mobility.
- Location and tenant occupancy are more important in the new market place than the former emphasis on the “best of the best” Class A building.
- Strong equity players will have a much greater role in the marketplace as 65/35% transactions will be commonplace.
- Undercapitalized ownership which cannot finance build outs or short term free rent offerings will be in a very bad position.
- Potential equity returns will be in the 9-12% range for AAA projects; 12-18% for value

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added projects; and, 20-22% for opportunity projects. Bank financing will be primarily focused on AAA projects only. Only highly capitalized long term players will have any capability to pursue value added or opportunistic projects.

- Emphasis on costs and avoiding risk may make Class B buildings more attractive than would have been true 3-4 years ago.
- Buildings in poor locations with poor occupancy may represent opportunities for not-for-profits by offering low rental rates.
- Medical and educational new construction projects have been the few active areas in the last few years.

### **Retail (including food and beverage)**

- The elimination of home equity lending and the control of credit card debt have removed, by some estimates, 20-25% of overall spending.
- Lack of consumption has become the new “badge of honor.”
- There is significant downward pressure on rents in a very competitive environment although there has been some improvement in the first quarter of 2011.
- Relatively newly constructed centers suffer the same problems as office centers as the debt ratio will far exceed property value when the term note is due leading to foreclosures.
- Co-tenants, location and competitive rents will be critical to success with an emphasis on co-tenants and location.
- There will be no speculative construction.
- As in office, the strongest equity players with the strongest tenant connections will be the survivors.
- Bank REO's will represent an opportunity for investors. However, all things being equal, this may lead to some “pirating” of tenants among centers.
- Old “B” and “C” centers may not meet the high vision of the community but they may represent an adequate ongoing return to the owner and therefore they are not going to go away.
- Emerging tenants in the new economy will have an emphasis on “value” as well as food and beverage offerings.
- Grocery anchored centers will remain popular in the near term.
- New definitions of “mixed use” will be explored (i.e. rental housing, medical office, retail and food and beverage interchangeable as part of one cluster).

### **Transportation**

- Need for connectivity to major job centers will dominate employment opportunities.
- As state and federal financing erodes, new highway and rail construction will require more local and/or user funding.
- More local funding may require the fee structure for roads (tolls) and rail to be more self sustaining.
- Even with these difficult times for transportation, America is yet to demonstrate that bus transportation at multiple economic levels is realistic.
- “Quality of life” (shorter commutes/rail) will be highly discussed. However, the discussion does not lessen the importance of cars and roads nor does it find financing for new rail lines.
- Given the Chicago metropolitan area's key national position as an intermodal transportation center, the movement of trucks and rail freight will have an equal (and perhaps better) priority position than the movement of commuters on roads and rail.
- The future of gas pricing and the ultimate impact.....who knows?

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- More road systems may consider “congestion pricing” as a matter of necessity.

- The future of aviation and airport building and location (O'Hare, Midway, Peotone (South Suburban), Gary).....who knows?
- While "high speed rail" is a popular topic it remains to be seen how long it remains a priority in light of other needs, limited public financing, and ultimate benefit.

### **Job Creation**

- Three fourths of current jobs are in service, tech or creative.
- A significant expansion of manufacturing jobs does not appear to be realistic.
- Transportation, inter modal operations and distribution represent a key growth area for well positioned suburbs.
- New job creation initiatives may revolve around ancillary and supportive services for job clusters in major job centers.
- Regional job growth needs to be grass roots based upon emerging economies.
- Transportation issues will put a premium on living and working as proximate as possible.
- As service and creative jobs continue as a backbone of the job economy there will be a growing premium on quality individuals with skills which will perhaps drive compensation up and begin to end the "low end job" stigma.
- Medical and education have been the key job creation areas in the past few years.
- Entrepreneurial people will do best in a competitive world. By nature, they will value "quality of life" issues which include live/work proximity and being in a physical environment which has a "sense of place." This will also imply seeking job satisfaction; lower housing debt; more spendable income; and, lower transportation expense

### **Finance**

- Higher equity has replaced a portion of bank financing for the foreseeable future.
- The higher the equity the more flexible the bank may be on both new deals and in restructuring old deals.
- While things go in cycles, expect "tight" underwriting (normal and better than the last decade) to continue.
- With so much equity on the sidelines expect equity players to have an interest in real estate and perhaps at lower returns than they may have demanded 4-5 years ago.
- High quality deals with less risk will be valued over maximized potential return (both by the investor/developer and the bank).
- "If I have a building I have a problem....if I have a tenant I have an opportunity"
- Only highly experienced developers with tenant connections will be considered by financing entities and potential equity partners.