2008 Corporate Real Estate Survey:
The Outlook for Expansion

Cash Crunch
Access to capital is key for all respondents **Page 2**

Economic Questions
Uncertainty about slowdown gives all players pause **Page 2**

Speculative Slowdown
Developers proceed with caution on spec projects **Page 3**

Locations in Transit
Transit-oriented developments get a demand boost **Page 4**

Expansion to Continue in Challenging Market

Despite volatility in the capital markets and a softening U.S. economy, developers and corporations are forging ahead with expansion plans for 2008. In an exclusive research survey conducted jointly by *National Real Estate Investor* and Coldwell Banker Commercial,™ 75% of developers said they expect the size of their real estate portfolios to increase in the coming year. By comparison, 44% of corporate respondents predict that their portfolios will increase, while 48% plan to maintain the status quo, and only 6% anticipate a decrease in the amount of real estate they own or lease.

In order to gain a better picture of the outlook for corporate expansion in the coming months, NREI and Coldwell Banker Commercial surveyed 259 developers and corporate space users in November 2007. Developer respondents are most likely to own, manage or develop office or retail properties (57%), while 50% of respondents are active in multi-family and 41% percent have a stake in industrial properties. Corporate respondents are most likely to be active in some type of service business (38%) or manufacturing (24%) and have a median of three locations.

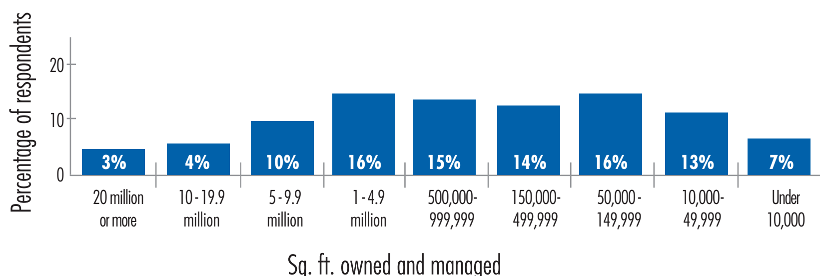
One of the most notable results of this year's survey was developers' confidence in expansion opportunities: Three out of four anticipate the size of their real estate portfolios to increase in 2008. At first glance, such confidence is at odds with the current market drama that includes an unstable economy and a seismic shift in debt-financing-markets. One explanation may be that, given the lead time on new development, many of the projects that will be completed this year were already underway in 2007.

On the corporate side, respondents are predicting a continued demand for real estate in the coming year. "They don't see portfolios shrinking. The response was largely flat or growing. So the market to me looks like it

Survey Methodology

On November 29, 2007, 29,634 subscribers of *National Real Estate Investor,* A Penton Media publication, received an invitation to participate in an online survey. A combined total of 259 respondents consisting of commercial real estate corporate end-users, developers, managers and owners completed the survey. Penton Research managed the methodology, data collection and analysis for this study.

Figure 1: Developer respondents that participated in the survey own and manage a range of commercial real estate portfolio sizes.



Base: All developer respondents (207)

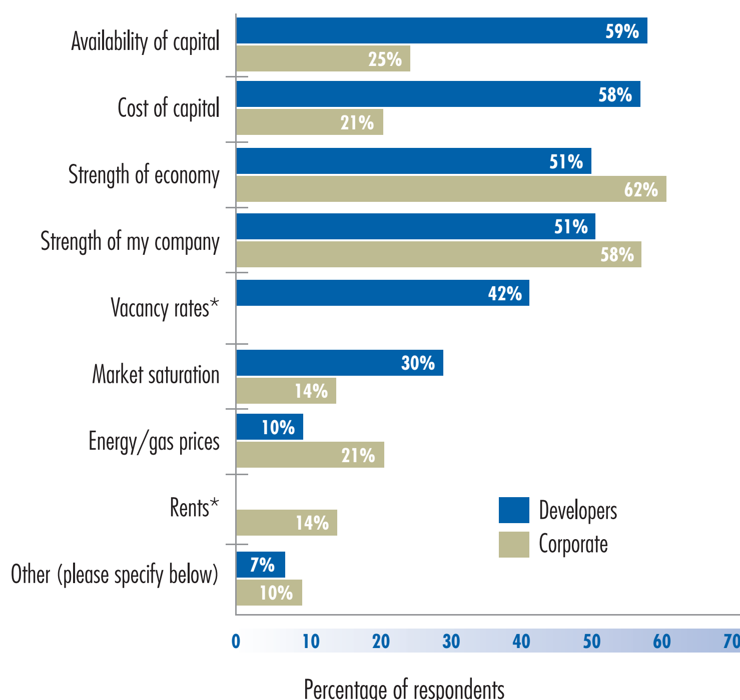
NATIONAL REAL ESTATE Investor
COLDWELL BANKER COMMERCIAL
RETAILTRAFFIC Where real estate, retail and development meet

is in equilibrium today," says Rick Davidson, president and chief operating officer of Coldwell Banker Commercial in Parsippany, N.J.

Such optimism in light of current market uncertainty stems from the fact that 2007, overall, was a solid year. "Fundamentally speaking, the commercial real estate industry performed very well in 2007," Davidson says. Vacancy rates remain healthy in every sector of the commercial real estate industry. On the office side, vacancies were also relatively flat at 12.6%, while rents rose 10.4% for the year to $24.57 per sq. ft., according to Reis Inc. On the industrial side, vacancies remained flat at 9.3%, while rents rose 3.5% for the year to $4.71 per sq. ft., according to Reis.

Many respondents anticipate that rents will rise further in the coming year. Most corporate users (44%) predict rental rates to increase in 2008, while 39% expect rates to stay the same. Only 4% expect rates to decrease.

Figure 2: Access to and cost of capital have the strongest impact on developers' acquisition and development plans, while corporate respondents' expansion plans are driven more by economic conditions.



Base: All developer (207) and corporate (52) respondents; multiple answers.
**"Vacancy rates" was included only on the developer survey and "Rents" was included only on the corporate survey.*

Cash is king

The crisis in the subprime residential mortgage market has led to tighter underwriting standards and higher capital costs in the commercial real estate finance arena.

Three-quarters of developers and 73% of corporate respondents saw a slight or significant increase in the cost of capital in the past 12 months. At the same time, 69% of developers and 51% of corporate respondents noticed a slight or significant decrease in the amount of available capital in the past 12 months.

More than half of developers said their development activity decreased as a result of the capital market volatility—35% reported a slight decrease and 18% indicated a significant increase. Nearly one-third (30%) said activity was not affected.

Relatively low-cost debt financing helped commercial real estate sale prices reach historic highs in recent years. "As the availability and affordability of capital declines, we're starting to see the buyer market thin," Davidson says.

The capital crunch is creating significant opportunities for investors and developers with deep pockets. The firm expects its access to cash to provide a significant advantage in the coming year. The REIT developed approximately $1.3 billion in office, industrial, retail and medical office projects in 2007, and Duke is expecting comparable activity in 2008.

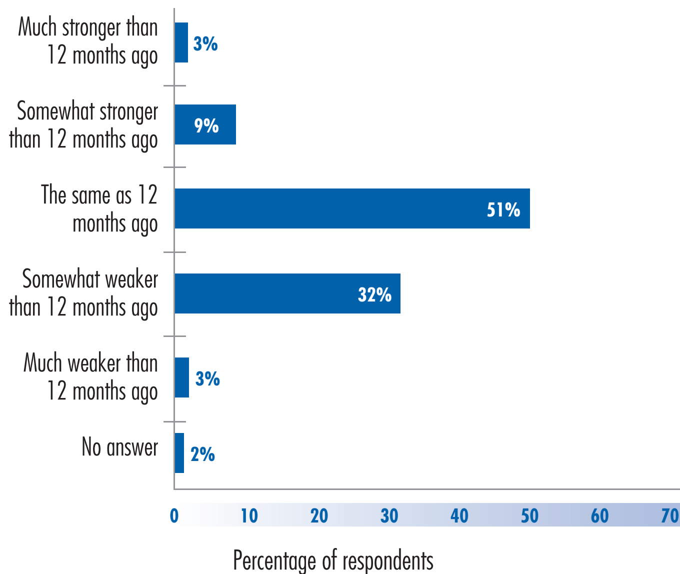
"Now that the leverage market has changed, it's more difficult for private developers to develop buildings, especially on a spec basis," says Sam O'Briant, senior vice president of the Southeast region at Indianapolis-based Duke. "But we think there is actually going to be more deal activity on the institutional side from REITs, pension funds and life insurance companies."

Economy wields influence

The economy will undoubtedly weigh heavily on corporate expansion decisions in the coming year. According to survey results, 62% of corporate respondents said that the strength of the economy will impact decisions in the coming year, followed by the strength of their company (58%) and availability of capital (52%) (see Figure 2).

"Companies are cautious, but I also

Figure 3: 51% of developer respondents think tenants' creditworthiness hasn't changed in the past year, while 35% believe it has declined.



Base: All developer respondents (207)

think they are keeping it in context with what they are seeing and forecasting for their specific business," says Eric Bowles, vice president of Atlanta-based CoreNet Global, a professional association for corporate real estate executives. For example, mortgage companies and financial institutions are more likely to be in a contraction mode due to the downturn in the residential housing market, while sectors such as life sciences maintain a steady growth pace.

One challenge is wading through the myriad of opinions and forecasts regarding the state of the economy. "There is a lot going on in our economy right now, and frankly, it's very difficult to put your finger on it," Davidson says. The fact that 2008 is an election year adds another layer of uncertainty to the mix.

Although the debate about a potential recession continues to rage, most economists are on record with forecasts of slower economic growth. Wells Fargo & Co., for example, is projecting real GDP growth for the year at 1.8%, down from the 2.7% growth rate that was achieved in 2007.

The big question is how the slower economic growth will influence corporate decision-making. "We are still seeing companies in expansion mode, but I would definitely admit there is more caution right now," says Kevin Hughes, executive vice president of corporate solutions for Colliers Turley Martin Tucker in Cincinnati. "I wouldn't predict a pullback necessarily, but companies are taking a little more time in their location decisions."

Yet some industry experts contend that the state of the U.S. economy holds less influence on expansion decisions than it did a decade ago. "Most of our clients are looking at the global economy versus just the U.S. economy," Hughes says. Colliers represents major corporations such as Procter & Gamble and General Electric that are increasingly influenced by international market activity.

Slowing spec development

The uncertain economic climate is already causing a pullback in some segments of the commercial real estate industry, such as speculative building. Slightly more than half of all development (52%) is now speculative, down from 61% three years ago (see Figure 4, page 4). "As market demand softens, certainly spec development will soften," O'Briant says.

Slowing spec development actually represents a positive shift for the commercial real estate industry. "The level of discipline that is in our marketplace today from the capital standpoint is stronger than it ever has been, and it has kept the supply side of our business in check," Davidson says. If the fundamental aspects of the marketplace don't make sense, these developments don't get funded.

And while developers are tightening standards on spec buildings, well-positioned projects will continue. Duke expects to move forward with spec building in markets with low vacancies where it already owns well-performing properties.

Opportunities for spec office projects remain in strong markets such as Phoenix and South Florida, O'Briant notes. For example, Duke opened a 107,204 sq. ft. spec office building in the fourth quarter at Millennia Lakes in Orlando. On the industrial side, spec development will likely continue in port cities as well as major metros such as Atlanta and Chicago, O'Briant adds.

Developers also are keeping a close watch on tenant credit at existing properties. Although over half (51%) of developer respondents said the creditworthiness of tenants at current properties is the same as 12 months ago, 35% of developers

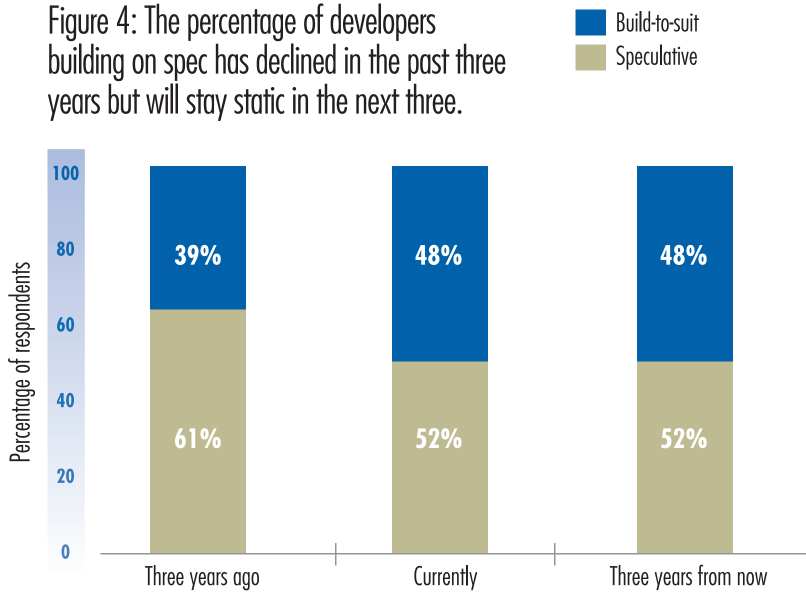


Figure 4: The percentage of developers building on spec has declined in the past three years but will stay static in the next three.

Base: All developer respondents (207); multiple answers

indicate creditworthiness is weaker than 12 months ago. Only 12% said tenant credit improved over the last year (see Figure 3, page 3).

Penchant for sale-leasebacks

The 2008 Corporate Real Estate Survey also revealed that a high number of corporate users are aware of the sale-leaseback financing model. Almost three-quarters of corporate respondents (71%) are familiar with the model, and nearly one in five (19%) said they used sale-leasebacks at some point. Among those who understand the model, 16% plan to increase their use of sale-leasebacks over the next three years.

Sale-leasebacks have been advantageous in freeing up capital locked in real estate. The financing structure also offers companies greater flexibility—a perk that is especially desirable when a company is looking to contract and reduce excess space.

Milwaukee-based Rockwell Automation Inc. completed a sizable sale-leaseback transaction two years ago when the firm sold off about 90% of its real estate portfolio. "The real goal they had was to create more flexibility in the business," Bowles says. Rockwell Automation ended up with a mix of short-term, intermediate and long-term leases—all of which were structured with the ability to terminate those leases early or extend, depending on business conditions.

"Where Rockwell Automation will really see the benefit of that is in a volatile business environment such as the current climate, because they will be able to take those business segments that are doing well and extend those leases, while on the other hand they are able to terminate early where conditions indicate that is appropriate," Bowles says.

Contemporary space needs

High fuel and energy costs are boosting demand for transit-oriented developments (TODs) and sustainable buildings. Forty percent of corporate users and 27% of developers said they currently own or lease space in TODs. On the corporate side, 56% of respondents indicate a transit-oriented location is important in the site-selection process and 39% consider it to be important for attracting the best and brightest employees.

"Many office tenants are looking at TODs as an option since it opens up a much broader employment base upon which to draw," says Rod Lawrence, a partner at The JBG Cos. in Chevy Chase, Md. JBG Cos. is building several mixed-use TODs in Maryland and Virginia.

"Transportation is becoming a much more critical priority, not only due to increased commuting times, but also as businesses begin to analyze their corporate environmental impact," Lawrence says.

Although trends such as TODs and green building have certainly piqued corporate interest in new facilities, industry observers expect both developers and corporate users of space to expand cautiously in 2008—at least until questions surrounding the economy settle.

"I really don't expect companies to be aggressively budgeting for new hiring given the current economic environment," Bowles says. Yet softening that blow is the fact that companies have an increasingly international presence, and the globe is not a one-size-fits-all economy, he adds. Countries such as China and India have been experiencing significant growth, and a slowdown in those countries may mean a dip from 10% to 6%—which still represents a tremendous growth rate.

"For a corporate user, the real estate cost is the least of their worries," Bowles says. "If companies have such demand where they need to hire people, the cost of the real estate per worker is very small compared to the productivity gains they can have from that." ■