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Positive signs spring up, but market not yet in recovery

By Marilyn Bowden

Photo by Marlene Quaroni

Falling tenant defaults are a good sign that the bottom of the real estate market is nearing, according to Matthew Adler of The Adler Group.

Office brokers experienced in the South Florida scene say there are some signs the market is nearing the bottom, but that should not be confused with recovery.

"If you look at the unemployment rate across the state and combine that with the overall statewide office vacancy, which is around 18% and probably still climbing, I don't think we can claim to be in recovery mode," said Jay M. Caplin, managing principal at Steelbridge Capital.

"There aren't any real material signs that we're going to be climbing out yet."

"Unemployment is the top driver," said Alex Zylberglait, vice president of investments at Marcus & Millichap. "We expect 43,000 jobs to be cut in the county this year, an increase from 2008, when 36,400 were cut. Not until unemployment slows down will we see real positive absorption numbers. People are confusing a slowdown in deterioration for growth, and it's not the same thing."

He estimated it will be the end of 2010 before there are positive signs of recovery in some local markets.

One sign that the market has reached or is nearing bottom, said Matthew Adler, executive vice president and chief investment officer at The Adler Group, is a significant decrease in tenant defaults.

"For those who have survived, it's now about enduring the length of the downturn," he said. "While we don't see any positive growth, from occupancy and rental rate perspectives we're close to bottom."

On the leasing side, Mr. Adler said, there's some activity in smaller spaces—those in the 3,000-5,000-square-foot range that are not candidates for the new office buildings coming to market over the next year.

"Some entrepreneurial start-ups are trying to take advantage of the opportunities this market is presenting them," he said, "as are companies that are downsizing."

But the majority of blocks available are larger, he said, and there's not much leasing activity at that level.

On the investment side, Mr. Zylberglait said, "velocity is down, but there are still deals getting closed. The deals getting done are opportunistic.

"Many buyers want to see more leasing activity before they jump in, but the biggest piece of the puzzle is the financial component."

Mr. Caplin said he doesn't foresee recovery "until banks start lending again in a more normal flow of debt that will allow transactions to happen."

Mr. Adler said he is getting some positive feedback from lenders, "though at 60%-65% loan-to-value, which are not historically great terms. But we do think qualified buyers are seeing receptivity from local banks.

"Lenders are motivated to prolong and delay the inevitable as opposed to realizing the bottom and taking the loss now, and I don't know what will cause that to change."

Another impediment to sales activity, Mr. Adler said, is "a huge spread between the bid and the ask. Some sellers are becoming more realistic, and a lot of people think over the next two quarters we'll see transaction volume pick up, because the stalemate can't go on forever. But it's still a trickle."

Going forward, Mr. Caplin said, "a lot of the buyers who were drivers of the market over the past few years are not likely to be frontrunners, as they continue to deal with problems of properties they bought at the top of the market. So we will see a new wave of investors leading the recovery."

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Alex Zylberglait

Although most well-capitalized owners who can afford to sit on their properties are not selling, Mr. Zylberglait said, that may not be the best strategy in a market that will, according to many observers, be very slow to recover.

"I think it's a good time to sell if the property is somewhat stabilized," he said. "I believe we are not likely to see a turnaround for some time, and then it will be a slow comeback. So there's no real upside for that asset. Its value is going to go down, and if it's stabilized in terms of exposure on the capital expense side and rent rolls, why not get out now?"