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Will the other shoe come down in 2010?

With a tough 2009 behind them, brokers are bracing for a critical year

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The economy as a whole may be coming out of a free fall, but that doesn't mean commercial real estate will be bouncing back any time soon.

With so much vacant space available, "you really won't see the market for new commercial real estate until some of that excess capacity is consumed," said economist Darin White, an associate professor of marketing at the **Brock School of Business** at **Samford University**.

"Commercial real estate traditionally is the last to come back" after a recession, White said.

That is certain to be a major topic of discussion later this month when commercial real estate experts from across the state gather in Birmingham for the 2010 Alabama Commercial Real Estate Conference.

BB&T Corp. CEO Kelly King, who will be the keynote speaker for the conference, said his company expects many of the same trends of 2009 to continue in 2010.

"Demand for new projects will continue to be weak due to elevated vacancy rates and stressed rental rates in most sectors," King said.

He said the most pronounced weaknesses will be in the hospitality and retail sectors due to decreased business and personal travel expenditures and lower consumer spending.

"We think this will continue to be the case until we see tangible signs of economic recovery, including job creation and a reduction in unemployment," he said.

While the problem of vacant space typically slows recovery in the commercial market, the present situation is compounded by a credit crunch that is making it hard for developers to get projects off the ground.

King said the bulk of commercial real estate financing opportunities in 2010 will be refinances for stabilized, performing properties.

Many in the banking industry have said regulators are also impacting commercial real estate financing.

"The view of regulators has been that banks have been much too exposed in real estate, and they are really clamping down," said David Wright, BancorpSouth regional president for Alabama and Florida. In regard to commercial real estate, especially construction loans, "they are much more rigid about the underwriting they are doing."

That logjam cuts across all aspects of commercial real estate, at least from the point of view of bankers.

"We've got so much empty retail space today, but I don't know of any segment in commercial real estate right now that is what I call very strong," Wright said.

Build-to-suit projects still have some traction among lenders, "but as far as speculative transactions go, I don't know of any banks that are willing to go out on a limb on one of those, at least not the way they might have been in the past."

Some in the real estate community meanwhile are tending to be a little more optimistic.

At **Brookmont Realty Group**, for instance, Managing Member Charles Simpson points to numbers that he says may give cause for hope, at least in the big picture.

Despite the slowdown, rates for office space in the Birmingham area have grown 2 to 3 percent a year over the last decade, while office occupancy rates are holding in the low 90 percent range.

The conservative nature of the local economy should continue to smooth out the bumps in the coming year.

"It's not a boom or bust city. It has had very conservative growth in all product types by comparison to our neighboring first-tier cities," he said. As a result, "the lows aren't nearly as low as they are in other cities."

Nonetheless, Simpson predicts a dry year in the office market.

The region will continue to suffer as the economy wobbles back onto its feet, he said, noting that a number of projects planned for 2010 have lately been shelved. He pointed out that four Over the Mountain projects in the 100,000 to 250,000 square foot range have been put on hold.

“I seriously doubt we’ll see any new building starts in 2010. I think you are looking at 2011 or 2012 before you (start) seeing anything being seriously considered,” he said.

Retail in the meantime is and likely will remain stagnant.

At Retail Specialists, President Robert Jolly points to a vacancy rate of 11.5 percent among local retail properties, a direct result of the sluggish economy. “Tenant bankruptcies are largely the problem in our market,” he said.

Even if consumers go shopping again, midsized retailers will be hard pressed to find suitable locations.

For those in the 1,500 to 10,000 square foot range, “their entire real estate strategy depends on the anchor developers, the Walmarts and Targets,” Jolly said.

“But there are no new anchor developments being constructed in our market.”

While commercial real estate may remain in the quagmire in the coming months, that doesn’t mean brokers will be sitting on their hands.

“Our guys are as busy now as they have ever been in terms of their pipeline,” although it is a different sort of activity than in the past, Jolly said.

Primarily, brokers are busy renegotiating leases, pushing down rates and angling for other advantageous terms. If nothing new is coming up out of the ground, the real estate community can at least remain active in its efforts to keep existing space occupied, Jolly said.

“I think that is going to be the way of the world for a while.”

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