

## Where is the real estate market and when will it return?

by Bill Griffith

It is understandable that while so many people are fixated on the global financial markets, developments that are taking place closer to home tend to take the backseat. Despite the financial gloom elsewhere in the world, anecdotal evidence gathered during recent conversations with some industry insiders suggests that there are bright spots in the local and national real estate markets (summarized below).

### Multifamily, Senior Housing and Franchise Outlet Land Sales are Hot

Local real estate developer, Terry McNellis, confirmed what many of us in the industry have been hearing for months: Multifamily development is going strong, as is demand for assisted living facilities and senior housing. McNellis said, "If lenders finance all the projects on the boards right now, the market will reach saturation quickly, but that is unlikely to happen soon." Yet it remains that the most likely projects to move ahead are those that lenders find attractive, such as those with government funding, such as tax increment financing and grants.

The Richdale Group, a multifamily developer based in Omaha, recently broke ground on The Luxembourg in Bloomington. The owner of The Richdale Group, Richard Slosburg, commented on the market: "From a multifamily perspective, it seems that the wheels are in motion for several additional projects coming online." He noted that while construction financing is still hard to come by in suburban markets, lenders are becoming more comfortable

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with infill development sites that have more upfront equity from the developer than has been required of them in better market conditions. Slosburg's son, Jake, who works with him, noted that "The challenge developers are facing is trying to deliver a project at an 'all-in cost' that will not require rents that are out of reach of a financially-strapped consumer."

Ted Gonsior, a land broker with Welsh Companies (recently associated with Colliers International), identified land sales for national franchise outlets such as McDonald's, Hardee's, and market newcomer Chick-fil-A as a growing market sector. Gonsior said, "We are optimistic that land sales will continue to pick up. Our land sales doubled from 2010 which doubled from the previous year." According to Gonsior, most deals take six to twelve months to reach closing, "so we are really working on projects for 2012." He noted most land deals are generally not large acreage projects and mostly include outlots, stand alone retail and stand alone business uses.

As noted by the Minnesota Real Estate Journal, Wal-Mart is very active in this space, and Target recently announced it will build in Inver Grove Heights, a project that was shelved at the outset of the recession. Gonsior said, "Anything that builds confidence will help lead to more activity."

Bruce Miller, a real estate professional and Vice President of MFC Properties,



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sounded a similar tone: "We are making deals on a regular basis. Sure, they are costing us more and we are giving more concessions than we might like, but we are making deals in our office, retail and medical portfolio." He too, noted that commercial land sales remain slow but starting to pick up: "I would say for landlords with the ability to fund tenant improvements and the willingness and ability to refurbish and keep the property up, the market is up." According to Miller, "It still doesn't make sense to take on new development due to tenant concessions and rental rates prevalent in the market."

There has also been a spike in industrial land sales due to couple of large distribution deals, including a 500,000 square foot shipping facility in Hudson, Wisconsin for Uline Shipping Supply Specialists, and a similar distribution facility for Medline Industries which

will build 250,000 square feet of space located in the Liberty Property Trust Industrial Park in Rogers, Minnesota.

### **Housing Continues to Drag Nationally**

Nationally, housing is still a significant drag on the economy. Zach Pandl, Senior US Economist at Goldman Sachs, estimates that about 2.5 million homes currently sit empty, which is well above normal vacancy rates. "In general, this glut of vacant supply is dispersed fairly evenly around the country, so it's a national issue, not a local issue." There are exceptions, such as Florida, that exist because of very high foreclosure inventory relative to the size of the its economy. Pandl noted a few positives, commenting that "Home prices have returned to much closer to 'equilibrium' levels. Whether compared to income levels or rental rates, homes are not 'obviously overvalued' across the country, nor are they 'obviously cheap.'" New delinquency rates have come down substantially. For instance, 30-day delinquency rates—a leading indicator of foreclosure—peaked some time ago. Pandl believes that the U.S. housing market will eventually recover: "It has to. With a steadily growing population, it is difficult to imagine a permanent state of distress in the housing market. People have to live somewhere, after all."

### **Commercial Construction Demand from Government and Private Sectors**

On the construction side, Rick Collins, Vice President with Ryan Companies in Minneapolis, noted a recent uptick. Ryan has been successful in winning construction projects outside of Minnesota in states including Iowa, Illinois, Indiana and Florida. Collins notes: "In order to keep our people busy, we have followed the work outside of Minnesota and have won contracts from the government and private sector."

Collins said he expected healthcare providers to make decisions to pursue new medical office projects following the enactment of healthcare reform. Instead, lingering uncertainty has made it difficult for health care providers to commit to long-term strategic investment. Collins stated, "Perhaps next year's election will change that: not because of party leadership, but because legislative gridlock has made it next to impossible to address the economy and

job creation." Minnesota's government shut down and the national debate over the debt crisis provide evidence of the stalemate. Yet Ryan, like others, is cautiously optimistic about the future and continues to hire project managers to take on new work on the construction side.

### **Mixed-Use Entertainment in a World of its Own**

Kurt Hagen is the Vice President of Development with Triple Five Corporation, with interest in Mall of America (MOA) in Bloomington, Minnesota, West Edmonton Mall in Edmonton Canada and the American Dream at the Meadowlands in New Jersey. He said the real estate market is difficult for large projects because of fear in the financing markets: "We are operating in a global economy and trouble in Europe has an impact on big projects over here."

On the other hand, Hagen believes that MOA operates in a micro-economy: "Sales grew every year during the recession. We didn't have a negative year, so it's not really indicative of what was happening to retail during that time." Hagen suggests a return to normal is still two to five years away, but is bullish on Mall of America Phase II because of MOA's solid performance history and proven ability to attract tourists, create jobs, and provide redevelopment opportunities. "Redevelopment and repositioning of existing assets is working right now because it is less expensive and less risky than buying land and starting from scratch."

### **Local Development Agencies buy Cheap Land**

Some communities have taken advantage of the down real estate market to by purchasing property for future development and redevelopment. One example is the Bloomington Port Authority's acquisition of office and industrial properties east of Mall of America, once owned by Duke Real Estate. A lesser-known example is the acquisition of 85 acres at the interchange of Interstate 35 and Lake Drive by the City of Columbus EDA. While some of the Columbus property will be used for future roadways, most will become prime sites for future development. Columbus City Administrator, Elizabeth Mursko, said "the City of Columbus has experienced a

decline in development over the past two years, but this has given our city staff and political leadership an opportunity to develop better ways to deliver city services, assess existing zoning code requirements, review the necessity to implement new regulations, and schedule workshops to evaluate long term planning strategies for transportation and land use." Both the Columbus City Council and EDA have established new goals for 2012 that include "an effort to have a more welcoming and streamlined application process for current and future residents and businesses who want to expand, relocate, locate a new business, subdivide land, or who simply want to build a garage."

*Bill Griffith chairs the Land Use and Real Estate Department at Larkin Hoffman in Bloomington, Minnesota. Bill practices extensively in land use, real estate and municipal law, and has represented Mall of America and the City of Columbus for many years. He also serves as an adjunct professor of land use law at the University of St. Thomas Law School in Minneapolis.*