



The Mortgage Bankers Association is relocating its headquarters from 1717 Rhode Island Ave. (approximately 42,000 square feet) to 1919 M St. (approximately 34,000 square feet). The association is trading square footage for higher-quality space.

SHORTER LEASES, SMALLER SPACES

D.C.'s office market activity slows due to federal budget-related uncertainty and shrinking office space requirements.

By Rachel Goff

The combination of concerns over possible federal budget cuts and a trend in tenants downsizing their office space needs continues to curb leasing activity in metro Washington, D.C., despite a handful of a few large transactions.

"Uncertainty has become our new normal," says John Germano, executive managing director of CBRE's Mid-Atlantic region. "In a marketplace where hesitancy and doubts over sequestration, the debt ceiling and

budget battles are likely to continue for at least the next six months, tenants continue to put decisions on hold. And those who are signing leases are looking at fewer square feet per employee."

The vacancy rate for the metro Washington, D.C., office market stood at 10.4 percent in the first quarter, down slightly from 10.6 percent at the end of 2012, according to commercial real estate services firm Cassidy Turley. One

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DEBT MARKETS HEAT UP

As financing options expand for borrowers across the Southeast, the commercial real estate community closely monitors rising interest rates.

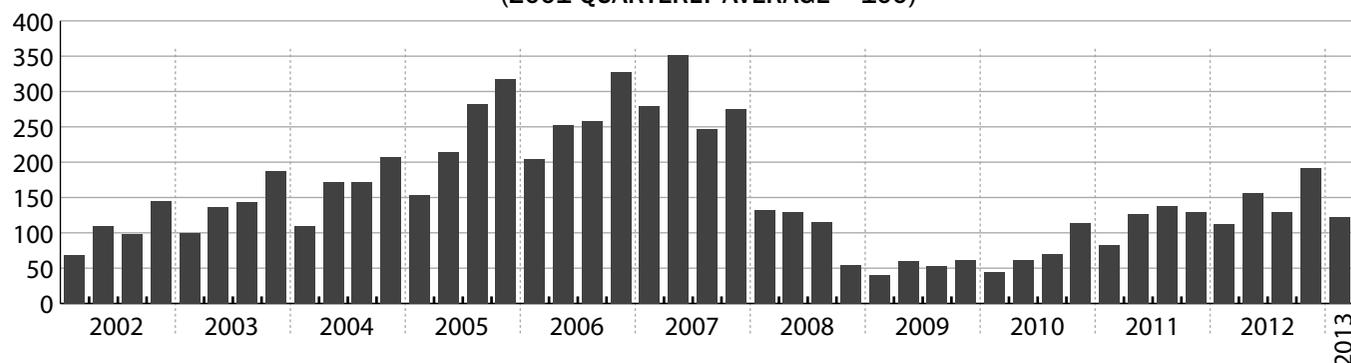
By Susan Fishman

The Southeast is enjoying a new wave of commercial real estate investment on the heels of the Great Recession, and the improving U.S. economy is creating more options for borrowers. Meanwhile, lenders see more transaction activity taking place in the value-add space as well a growing interest among investors in secondary and tertiary markets. The confluence of events will result in a healthy year for loan production in the commercial/multifamily sector, say industry experts, despite rising interest rates.

According to the Mortgage Bankers Association, see **LENDING**, page 19

Commercial/Multifamily Mortgage Bankers Originations Index

(2001 QUARTERLY AVERAGE = 100)



Lending volume in the first quarter of this year rose 9 percent from the first quarter of 2012. The uptick was driven mainly by increases in loan originations for hotel and multifamily properties.

Source: MBA

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DEBT MARKETS HEAT UP

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ers Association's (MBA) Quarterly Survey of Commercial/Multifamily Mortgage Bankers Originations, first-quarter 2013 commercial and multifamily mortgage loan originations were 9 percent higher than during the same period last year.

"The overall number masks larger increases in the dollar volume of loans originated for commercial mortgage-backed securities (CMBS) and Fannie Mae and Freddie Mac, and a decline in the amount originated for life insurance company portfolios," says Jamie Woodwell, vice president of commercial real estate research for the Mortgage Bankers Association based in Washington, D.C.

The 9 percent overall increase in commercial/multifamily lending volume during the first quarter on a year-over-year basis was driven by increases in originations for hotel and multifamily properties, according to the MBA Survey. Specifically, the increase included a 35 percent spike in lending on hotel properties, a 30 percent increase for multifamily properties and a 2 percent increase for industrial properties. On the flip side, lending volume for retail property loans dropped 25 percent, followed by a 15 percent dip in the healthcare sector and a 6 percent drop for office property loans.

Walt Mercer, executive vice president and head of the commercial real estate line of business for Atlanta-based SunTrust Banks Inc., says that the Southeast is generally highly attractive from an investor's point of view because of its right-to-work laws, favorable demographic trends and economic factors. But so far this year, there are three different stories playing out in the market.

"We have seen what amounts to a trifurcation of real estate in the Southeast," he notes. "At the very top of the market, it's extremely competitive and there is excessive demand for debt — and not enough to go around. In the middle part of the market, there are some cities that are seeing growth and others that aren't. It largely depends on where vacancies were when the economy began to slowly rebound. At the bottom part of the market, there are still owners/developers struggling to make sure that their transactions with lenders are restructured properly — or they are dealing with commercial mortgage-backed securities that will mature soon."



Walt Mercer
SunTrust Banks Inc.

Many lenders experienced a banner year in 2012 for commercial transactions in the Southeast and look forward to similar results this year as reflected by year-to-date property and portfolio sales, a leading indicator.

According to Doug Murphy, director of analytics for New York-based Real Capital Analytics (RCA), property sales in the Southeast year-to-date through May totaled \$18.1 billion based on deals \$2.5 million and above. That's up from \$15.5 billion during the same period a year ago. The trend nationally is much the same. Commercial and multifamily property sales across the United States totaled \$17.9 billion in April alone, according to RCA, up from \$16.3 billion in April 2012.

The apartment and retail sectors recorded 6 percent year-over-year gains in property sales volume while the rest of the property sectors were largely flat except for development sites, which experienced its first monthly decline in more than two years, according to the May 2013 RCA report on U.S. capital trends.

"We are currently experiencing the healthiest capital markets environment we have seen since the period preceding the global financial crisis," says Dan Fasulo, managing Director of RCA. "There is a plethora — if not a surplus — of capital available on both the equity and debt side for income-producing properties. The capital markets improvement is reflected in transaction volumes and values, which have increased significantly during the past 12 to 24 months. The current surplus of capital is driving investors and lenders to expand their horizons both geographically to secondary markets and to lower-quality properties in order to access opportunities."

Nationally, Wells Fargo's commercial real estate platform posted more than \$63 billion in originations in 2012, compared with almost \$60 billion in 2011. Last year was also good for Beech Street Capital as a whole, and particularly in the Southeast region. Beech Street's overall production of nearly \$4 billion in closed loans nationally included a Southeast production of more than \$603 million, almost double the production for 2011.

A10 Capital, which specializes in small to mid-market commercial real estate loans (loosely defined as \$1 million to \$15 million in size per asset), posted a record year in 2012 and is targeting between \$400 million and \$500 million in new loan originations in 2013, according to Chuck Taylor, principal and executive vice president. Taylor is responsible for sourcing all new business opportunities for A10 Capital in the Southeast.

"Since the beginning of 2012, approximately 73 percent of our business has either been acquisition fi-

ancing or the recapitalization of a recent acquisition (including note financings). The other 27 percent has been refinancing or discounted payoff business. On the value-add side, on most transactions, it really makes sense to get a new "reset basis" in the deal, and that typically comes with a new acquisition, says Taylor.

"A reset simply means that the borrower is acquiring the property at a much lower value than the previous owner. A lower reset basis enables our borrower to offer more competitive rents than other comparable properties that might have a higher basis," explains Taylor.

While sales remain steady, owners are driving prices higher in direct proportion to gains in employment, according to the RCA report. A rise in property prices in cities like Orlando, Jacksonville and Tampa is directly related to employment trends for those areas.

Mitch Sinberg, a nationwide originator of multifamily and commercial real estate debt financing and manager of Beech Street Capital's Florida offices, agrees that economic recovery has been continuing in many Southeast markets, particularly in the more urban areas where job growth has been steadily increasing.

"In addition to job growth, favorable demographic trends are having an impact with millennials looking to move out of their parents' basements, and boomers cashing out equity for retirement and opting to rent," he notes. "Specifically, we're seeing development in Southeast markets including Nashville, Atlanta, Charlotte, Raleigh, Miami, Tampa and Orlando."

Deal Preferences

Thus far, some of the most active property types for lenders in 2013 have been office, industrial, multifamily and retail. Wells Fargo, which had a nearly \$3.5 billion increase in loan originations from 2011 to 2012, continues to lend to all property types.

"The best lending opportunities across the country are where we are able to leverage our entire platform to provide traditional financing via construction, short-term acquisition,



Chuck Taylor
A10 Capital



Mitch Sinberg
Beech Street Capital

or bridge to a permanent solution via our CMBS or multifamily capital capabilities," says Hugh Allen, senior vice president and Mid-Atlantic division manager for Charlotte-based Wells Fargo Commercial Real Estate. "Specific to the Southeast, we see opportunities where there is significant job and population growth in places like Charlotte, Raleigh/Durham and Charleston."

Wells Fargo recently financed two different properties: a grocery anchored shopping center in Fayetteville, N.C., and a hotel in Baton Rouge, La., both of which received traditional financing in tandem with New Markets Tax Credits.

SunTrust sees opportunities as a lender in the multifamily, industrial, office and retail sectors. There is currently plenty of demand for refinancing in the office sector and steady demand for multifamily construction financing. "A lot of pundits have seen multifamily as overheated, but our research suggests that there will be strong demand for rentals in the future," says Mercer. "The question is whether you're putting the right apartment complex in the right location. You don't want an 'A' property in a 'B' location."

The widening of the Panama Canal and the proposed deepening of the Port of Savannah and other ports, along with rising domestic energy production and consumer demand for speedier delivery of products, will also likely drive demand for industrial capacity, Mercer notes. "Amazon, for example, is trying out same-day delivery of certain goods. As a result, we are seeing more inland projects at the intersection of railroads and interstates. While this may not necessarily be a market maker, it will move the needle in the Southeast."

A10 Capital is focused on the retail, office, industrial and multifamily sectors and will finance some other niche property types such as self-storage, manufactured housing. "As far as underwriting, we go up to 70 percent leverage on most property types and can go higher for larger deals over \$10 million," says Taylor.

The company just closed three acquisition loans in the Southeast region in May alone — one retail and a short-sale office deal in metro Atlanta, and another office deal in metro Orlando. "All three transactions had some vacancy, but were fundamentally solid real estate that had suffered through a prolonged period where the previous owner would not make any new investments (capital expenditures or tenant improvement leasing commissions) in order to attract new leasing," notes Taylor.

"We see this story over and over again, and these acquisitions establish

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a new reset basis to allow the deal to compete in a new rental rate environment. A10 Capital can provide a forward facility to pay for future lease-up costs, all on a non-recourse basis."

CMBS Financing Rebounds

The dollar volume of CMBS loans originated for conduits in the first quarter of 2013 increased by 170 percent compared with the same period a year ago, according to the MBA Survey. There was a 36 percent increase for government-sponsored enterprise (GSE) loans, an 8 percent increase for commercial bank portfolio loans, and a 21 percent decrease in dollar volume of loans originated for life insurance companies.

Wells Fargo's current lending activity is approximately 60 percent construction financing and 40 percent permanent financing (including acquisitions, mini-perms, refinancing or standing loans). In the Southeast, the company is currently very active in lending to private developers, says Allen. "Some of the private developers who weren't as active during the downturn are now back in the market and actively seeking new opportunities," he notes.

A10 Capital is focused on value-add

bridge and mini-perm loans. Its loan note purchase program offers financing for the purchase of a distressed note versus the fee interest. "Because we are not a bank, we have some flexibility in terms, but right now we want to be best in class as a non-recourse bridge lender focused on the middle market transactions," says Taylor.

Sinberg says that continued demand for high-quality, multifamily assets has led to cap rate compression for Class A assets in most of the major markets. "Many investors are seeking value-add opportunities or quality assets in secondary and tertiary markets to find opportunities for increased yields," he says. "As it relates to value-add opportunities, we are presenting our clients with bridge opportunities with the idea of capturing the permanent debt once the asset reaches its potential."

The CMBS market has had some surprising activity so far this year, according to Trepp analyst Joseph McBride, including consistent spread tightening through all levels of the credit stack, a hot start to the year in terms of new issuance, and a large amount of large loan and single-asset deals — about \$17 billion of the \$37 billion in total issuance recorded year to date as of June 7.

According to Trepp, July 2012

marked a turning point for the CMBS space as the wave of maturing five-year loans subsided. These loans had boosted delinquency rates, appraisal reductions and losses in the first half of 2012.

Trepp's estimate for 2013 is for total CMBS issuance to be in the \$60 billion to \$80 billion range.

Interest Rate Watch

The 10-year Treasury yield stood at 2.6 percent as of June 24, up about 100 basis points from the end of April. What's behind the steep climb in a short period of time? Sinberg points to two factors: speculation that the Federal Reserve is going to slow down or eliminate quantitative easing and an improving U.S. economy.

"It's hard to say in the short term where rates are going, but we are still in a historically low rate environment, so in the long term they will continue to increase. Although rates may not be as attractive as they were a month or two ago, we are still strongly advising clients to fix long-term debt while rates are still at a very attractive level from a historical perspective," says Sinberg.

"Overall, I think the sentiment is right that rates have to head higher eventually, but trying to time these things is difficult," adds Taylor.

"Clearly, when rates do head higher, we would expect cap rates to follow. But that may not be the worst thing in the world, particularly if those events are tied to strong economic indicators (job and wage growth) along with better overall occupancies and rents."

The availability of debt has increased across the board during the past few years, say lenders. And at today's low rates, that debt is highly attractive to borrowers. But there is also increased competition, says Mercer of SunTrust. "For example, when we have a client that asks us to look at refinancing an existing trophy office building in a prime location, it is not uncommon for 30 or 40 different entities to bid on providing the debt. And it's not the usual suspects as in the past. It now includes private equity and venture capital, opportunity funds, insurance companies — all sorts of different lenders. Everyone is looking for yield and revenue growth."

Taylor notes, "In light of recent events, we expect that everyone will continue to watch the Fed and Congress closely. This has been a familiar theme lately, but any sudden moves by either group could provoke the bond market, and that would become the big story for the second half of 2013." ■

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space in the Washington, D.C., office development pipeline is scheduled to deliver by the end of 2014.

Two redevelopment projects totaling 152,000 square feet delivered to the D.C. office market in the first quarter. In the central business district, Monument Realty and Angelo Gordon's 127,000-square-foot redevelopment office condo project at 2055 L St. is 74 percent sold to the National Restaurant Association and the Center for Global Development. In the East End, Arch Square at 801 Seventh St. completed renovations on 25,000 square feet of office space, with 71 percent leased to the Alliance of Automobile Manufacturers.

Tenants in the area continue to flock to newer, high-quality office space, while leaving a bulk of available large-block space options in Class B and C buildings. Given the soft market conditions in Washington, D.C., owners of these B and C buildings will offer lower rents and tenant improvement allowances to entice new occupants, according to Cassidy Turley.

"The sense of place is absolutely on the radar screen as a critical employee benefit. People want to be in vibrant, 24/7 environments, and access to transportation is very important," says McNair. "I think in this soft market we are witnessing the proverbial flight to quality with tenants upgrading spaces." ■



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- APM: 6.1 miles
- PMT: 6.9 miles
- NIT: 10.2 miles
- NNMT: 10.9 miles

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