REPRINTED FROM THE

FRIDAY, JANUARY 27, 2006

NEW ENGLAND Real Estate Journal

THE LARGEST BUSINESS PUBLICATION OF ITS KIND IN THE NATION

Charging into twenty ought-six? Real estate is in the middle of a series of robust months

Dan Mee

Tremont Realty Capital

The cryptic name for the current annum might sound like some kind of bullet shell, and while we may not have a gun shot economy, the reality is real estate is in the middle of a series of robust months. In general, by almost every account, 2005 was a good year.

The US commercial mortgage backed securities (CMBS) market easily had its best year ever with about $160 billion in new issuance. This exceeded 2004's previous record setting performance by over 72%. Combine this with the plethora of other capital sources: banks, life companies, pension funds, opportunity funds, hedge funds, private capital and you have an ample supply of real estate's basic raw ingredient for growth: cash.

The office sector saw its recovery gain momentum nationally, as vacancies continue to decline. With significant inventory taken off market for residential conversion and restrained new construction, the office market had its best performance in six years.

Retail properties enjoyed a very strong year due to steady jolts from continued consumer spending. Big malls and infill neighborhood centers in upscale suburban markets look sound. The caution here going forward would be that rising energy costs, higher property taxes, higher consumer credit interest rates and increasing medical expenses could start to slow consumer spending.

In the industrial market, rents remained relatively flat as usual, but the strong retail sector drove a strong performance by the warehouse sub-sector. In addition, "border-industrial" activity especially in south Texas and New Mexico saw considerable activity. Players in this field have been enhanced with the institutional investors who like this classic core sector and provide excellent liquidity. Also, the newly active tenants-in-common (TIC) buyers jumped on many single tenant assets as this structure fits well with their business plans.

With occupancy rates approaching 70% hospitality had its best year since 9/11. Clearly showing their positive correlation to an improving economy, many feel this is the market sector with the most upside. Resorts and destination cities show the most potential. Many center city locations like New York and Los Angeles have also benefited from former hotels going offline to be converted to condos.

Astronomical home prices, higher home building costs, rising mortgage rates, and rising numbers of echo-boomer renters are predicted to boost occupancy and rents throughout 2006 and into 2007. These factors have also resulted in a leveling off of "the condo craze". That part of the housing sector has even turned downward in some over built markets. Fortunately however, no crash, as some predicted, is looming. Such an event could be catastrophic as this bellwether sector would suffer dramatic "cap rate expansion" that would bleed into other sectors touching off a credit squeeze as values depress. Most expect condos, which are primarily a coastal phenomenon, to have a soft landing with prices relaxing to a point where marginal new inventory is curtailed. Indeed this was experienced this last spring/summer when over the course of just a few weeks it seemed like every lender in the country got the same memo: pull back from condo development. The result was astonishing as a whole series of pending deals were tabled awaiting better capital and market conditions.

The above occurrence of the capital slow-down for condo development was a refreshing change for an industry with a sad history of overbuilding six, twelve or eighteen months into a downturn and thereby creating regular supply-driven recessions (read: bust). Could this be an indication that the long awaited maturity of the real estate industry has finally occurred? Certainly the seemingly unlimited supply of institutional capital trying to get into real estate would be evidence that this is the case. Such investors never put their capital for long, into sectors that lack a transparency and good information.

In summary, while there is some need for reasonable caution, especially with rising energy and capital costs, and the need to keep a close eye on consumer spending, 2006 should continue the upward trend. Real estate, as always, is a micro economic analysis. So conventional wisdom suggests with a keen eye and a rifle approach to investment, this market should enjoy another good year.

Dan Mee is executive director, Tremont Realty Capital, Boston, Mass.