Real Estate Report

Slowdown Ready to Become Turnaround?

Location, location, location. It's an often-repeated phrase in real estate for the most important attributes leading to a successful transaction.

Four major markets in Indiana come in geographically diverse areas — Indianapolis, Fort Wayne, Evansville and South Bend. Despite these varied locations within the state, there are a number of similarities when it comes to recent real estate performance and the impact of industry issues and trends.

Coming together to discuss these topics and more are:

Participants

Jeff Henry, managing principal of Colliers Turley Martin Tucker in Indianapolis

Bill Martin, managing director of CB Richard Ellis/Sturges in Fort Wayne

Drew Platt, commercial/industrial sales associate with F.C. Tucker/Huber in Evansville

Brad Toothaker, managing director of brokerage services for CB Richard Ellis in South Bend

Rebound doesn't occur

A look back at 2002 reveals mixed results. Expectations at the beginning of the year were certainly high, but the anticipated bounce back in the economy never materialized.

"I think everybody was saying that by the middle of 2002 to the end of 2002, we might be back to normal and it's been much slower than that," Henry notes. "I'm not sure anyone wants to guess when we're going to be back to normal, but hopefully it's going to pick up in 2003."

Toothaker agrees from an overall perspective, but points out that retailing opportunities and highly desired locations have kept his company busy in the South Bend area. Many deals, however, seem to be proceeding at a slower pace.

"A lot of people in our community would say that the average life cycle of the transaction is longer and more arduous than it's been in the past," he says. "Whether it's getting (the deal) underwritten or it's scrutinizing the move entirely or the different dynamics that come into play, that's been one of the challenges."

Several hospital building projects on the north side of Fort Wayne have kept that market active, according to Martin. Those were necessary as manufacturing and warehousing developments in 2002 saw "a complete turnaround from what we had last year."

Platt also anticipated a boost by the middle of the year, but says, "It just has not been that way."

Changing the rules

Concessions are one of the methods used to try to enhance the number of projects taking place. The philosophy comes down to supply and demand: More shoppers and people in the marketplace, the lower the need for special incentives; the larger the supply of buildings and vacancies without commensurate demand, the more concessions come into play.

The South Bend market saw such changes near the end of the first quarter of 2002. There were some cutbacks in rental prices, but many of the concessions were at a more dramatic level.

"It starts with free rent," Toothaker says. "Sometimes free rent has been utilized in lieu of an owner coming up with capital because of the tight operating nature of some of the assets that are out there. Some of it has been pretty aggressive in exchange for longer-term commitments."

A reduction in square foot price is an alternative to free rent for a limited time.

"Typically, our A space is $18 space, and we're seeing that price drop by at least two or

By Tom Schuman

three dollars a square foot. It goes down to some of our new B space being as low as eight and a half or nine dollars (a square foot), just to get people into them," Platt explains.

The economic times call for strong actions.

Martin: "I've told the landlords that our firm represents that we need to be aggressively making deals. If that means free rent for 60 or 90 days or going below market on some rents, we're going to do that. Right now it's tough and who knows what's going to happen next year."

The supply and demand formula, at least in regard to office space, comes down to job growth, Henry believes. It's no secret that the state, along with many others, has suffered in that area in recent years.

"If you have no job growth or negative job growth, then you aren't going to have any positive absorption in office space," Henry relates. "With some owners that's where the concessions start. They start generally with free rent, and then it goes to whether you want to get into giving moving expenses, picking up existing lease obligations and whatever else you might want to do."

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CB Richard Ellis/Sturges, Fort Wayne

Economic indicators

The slow or non-existent job growth is a byproduct of a struggling economy. While it is a sign of potential struggles to come, are there other earlier indicators that the real estate professionals rely on in their communities?

Toothaker says he benefits from a local economic barometer that is also used as a national indicator. That is the recreational vehicle and manufactured home industry in Elkhart County.

"I understand the *Wall Street Journal* uses that as one of their primary barometers for going in and coming out of recessions," Toothaker remarks. "The more want ads there are, the more robust the economy is in that area. And it's the first place you'll usually see a sign of recovery."

Martin counts on a similar measure in Fort Wayne, keeping a close watch on production at the General Motors truck facility. The other key is networking with local professionals. Martin lists architects, contractors, attorneys and bankers among those whose jobs offer a pretense of things to come.

Henry notes that some of the past indicators — higher interest rates or lack of interest in people wanting to buy ground for future development — have not been present this time around.

"I think that's what caught everyone by surprise. When we went into 2001, interest rates were still low and people still had an appetite for ground," he recalls. "It hit us overnight because you had a lot of businesses that all of a sudden weren't showing profits."

A local phenomenon in Evansville has been a downward turn in residential real estate one year foreshadowing a commercial slump the next year. There may not be a logical connection, but it has been proved out over the years.

Low unemployment has also always been a concern in southwestern Indiana.

"For us to have growth," Platt says, "we need people to relocate down here. Otherwise, we just won't have anyone to staff anything."

Going downtown

Although much is written and said about urban sprawl and businesses moving away from central cities, downtowns remain a vital part of the real estate picture. Growing, vibrant downtowns are essential to overall community strength.

Fort Wayne has an alliance including city, county and local chamber officials, among others, looking closely at downtown revitalization.

One of the areas focused on, Martin says, is bringing residential growth to the area. "We're all there during the day, but at night there still needs to be something going on."

It's no different in the other cities. Henry cities the Indianapolis office space expansion of the 1980s, followed by the retail and commercial boom of the '90s.

"I think we're finally putting the final piece of the puzzle together, which is the residential portion," Henry theorizes. "The one thing that will help the office market downtown more than anything will be the residential aspect. It will bring the labor pool back to the downtown area. It will bring the decision-makers back to the downtown area."

Evansville has several factors in place — recently reopening Main Street to vehicle traffic, several new corporate headquarters on the way and a potential minor league baseball stadium — to encourage downtown growth.

Platt says the residential factor is still lacking and "that's absolutely essential to attract the restaurants and other businesses that you need to have a vital downtown market."

Toothaker notes that South Bend's downtown has enjoyed a strong run in recent years with investment from both the public and private sectors. Whether redeveloping existing buildings or clearing the way for new entries, the key is putting all the factors together so the economics of the deal make sense.

On the residential side, he adds, "We have a decent residential

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> *CB Richard Ellis, South Bend*

component, but we're lacking some in the mid (price) range. That goes back to some of the higher income, younger people (who have come) to our downtown area, so I think there's a demand for the housing."

Adding the perks

Amenities have always been a factor in real estate decisions. While those extras — ample parking, conference rooms that meet their needs, nearby food and workout facilities, child care availability where appropriate — haven't changed a great deal, the demand for more has increased.

"What you're seeing," Henry comments, "is that everybody wants all those amenities available at one location. Five or 10 years ago, if you had one of three (amenities), you were OK. High-tech companies then wanted an environment that could service their people 24 hours a day."

The economic slowdown, though, has forced some companies to now look closer at the bottom line than the amenities package.

Toothaker adds that the demand for these services is helping fuel the downtown rebirth in some locations. Retail and other services available within a short walking distance can be a selling point to some companies.

Tax and environmental concerns are always issues that must be watched closely. The upcoming elimination of the inventory tax is a positive factor, particularly for the Evansvilles and South Bends that face stiff competition from neighboring states.

Environmentally, Martin says, "I have a transaction that I'm working on that I think is going to go sideways because of that."

Toothaker points out that South Bend and Mishawaka each have urban renewal sites that carry environmental challenges. But he believes there are more "people with solutions … and funds available" to make the obstacles less daunting than a few years ago.

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Time for change

Optimism is the name of the game for 2003.

Henry says he is "seeing some positive signs in the marketplace." Martin expects "an increase in activity. Toothaker sees the patience of the last few years wearing thin with people ready to "do what they need to do to grow their business and move forward." Platt cites the importance of consumer confidence, with the "anticipation of seeing an increase in capital expenditures."

On a national scale, it appears to still be a wait-and-see game. *Emerging Trends in Real Estate: 2003* describes the coming year as "doldrums -- not despair." The 24th annual publication, based on a survey of leading real estate authorities, adds, "The weak economy and its related effects will soften the U.S. commercial real estate markets for at least another year.

"Rising vacancies, corporate belt-tightening, downward rents and rising expenses will make 2003 a problematic, but manageable, year for investors. ... Most indicators point toward a recovery in 2004."

The bottom line: Stay tuned for further developments. No matter the location.

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Panelists Provide Market Overviews

Each of the ExecConnect participants was asked to provide a summary of the current real estate markets in their communities. Below is a synopsis of their comments:

- **Jeff Henry, Indianapolis:** Office market holding steady with vacancy rates constant at around 17.5%. Construction taking place in owner-occupied buildings and medical facilities, with little construction in multi-tenant buildings

  Big box retailers (Home Depot, Lowe's, Kohl's, etc.) continue to dominate the commercial retail market, but that will likely come to an end in 2003. Restaurants are continuing to come into the area. There is a slowdown in the sale of ground for hotels and motels, but low interest rates have home builders grabbing every large parcel of ground they can. Overall activity is rated as moderate.
- **Drew Platt, Evansville:** Office market divided into two locations — the traditional downtown district and a suburban (primarily east side) growth area. In a strange twist, vacancy rates for Class A, B and C space are all running at about 15% outside of downtown

  Retail expansion has been strong, with many of the larger operations moving into new facilities and leaving vacant big box space. Home sales were on their way to a record year for the area and there has also been apartment growth. Lenders, however, are beginning to become cautious about new multi-family developments.
- **Brad Toothaker, South Bend:** Stability has come to the office market. Subleased space has been reabsorbed and rents have generally returned to where they were about 18 months ago. Banks and hospitals are leading a surge in new office development

  Retail has been strong in the past year from both large retailers and the smaller specialty shops. It has also been geographically diverse, with impressive growth on the south side of South Bend in addition to the traditional Mishawaka strong point. Several buildings in the 500,000 to 800,000 square foot range (larger than normal for the area) have either been built or are planned. There has been good parity in the single and multi-family markets.
- **Brad Martin, Fort Wayne:** Activity in the office market has been focused on the suburban areas as vacancies remain downtown. Medical industry expansion, including two new hospitals, has been a big plus

  Jefferson Pointe, an open-air retail development referred to as a lifestyle center, has offered an alternative to the traditional mall setting. Northeast Fort Wayne is also seeing strong growth. Industrial activity has slowed. Manufacturing buildings have become available, but are not moving as quickly as in the past.