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U.S. Commercial Real Estate Recovery to Advance in 2013 with Nationwide Gains in Leasing, Rents & Pricing, According to PwC US and Urban Land Institute's Emerging Trends in Real Estate Forecast

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The real estate recovery is set to advance in 2013 as modest gains in leasing, rents, and pricing will extend across U.S. markets from coast-to-coast and improve prospects for all property sectors, according to the findings of the Emerging Trends in Real EstateÂ® 2013 report, released today by PwC US and the Urban Land Institute (ULI).

According to survey participants, despite a slower-than-normal real estate recovery track, U.S. property sectors and markets will register noticeably better prospects as compared with last year.

Recent job creation should be enough to increase absorption and push down vacancy rates in the office, industrial, and retail sectors, helped by the limited new supply in commercial markets. Robust demand for apartments should hold up, survey respondents indicate, even as new construction ramps up - and even the housing sector makes progress in most regions. Additionally, improving fundamentals should help with rents and net operating incomes, building confidence about sustained growth and strengthening recent appreciation.

"With the outlook for commercial real estate continuing to improve in 2013, investors are expected to allocate substantial sums of capital to the real estate asset class, according to our survey respondents," said Mitch Roschelle, partner, U.S. real estate advisory practice leader, PwC. "As yield in bonds and other financial instruments tighten in a still volatile market, commercial real estate's income producing and total return attributes offer investors potentially attractive risk-adjusted returns."

Stephen Blank, ULI's senior resident fellow for real estate finance, noted that investors must keep in mind recent progress made in the industry as they prepare for a slow but steady recovery. "What these findings suggest is that, in general, the industry is moving forward bit by bit. Nothing indicates a quick turnaround for commercial real estate, but it is improving. Those who are patient and willing to rethink their expectations and adapt to market realities are expected to come out ahead this year."

Capital Chases Yields

Despite macro-economic concerns, the 2013 Emerging Trends forecasts that investors will return to greater risk-taking in their portfolios in an attempt to gain more yield. Even as riskier secondary markets show up on investors' radars, many believe the move cannot be made without concentration on leasing to high-quality tenants within growth industries that are sustainable. However, as property prices meet or exceed pre-recession levels in the cities of- San Francisco, New York City, Boston, Washington, D.C., Los Angeles, and Chicago, the focus of property investors has shifted more to the lessee's value, various market demographics, a city's economic production, diversification, job growth, and where people want to live.

According to the report, investment capital's interest in commercial real estate is expected to increase as other asset classes continue to offer minimal returns or too much volatility. In fact, Emerging Trends found that only six of the 51 markets covered exhibited a decline in investment prospects.

Transaction volume is expected to tick up with more action in 2013, according to Emerging Trends. Pricing is predicted to strengthen, but increases will be muted until credit markets return to more normal states. Commercial mortgage-backed securities (CMBS) may return to the financing spotlight once transaction activity increases. Interviewees expect that CMBS issuance can return to a $75 billion to $90 billion level over the next several years.

Respondents to Emerging Trends cite a number of best investor bets for 2013, which include:

* Concentrate acquisitions on budding infill locations: Top urban markets outperform the average, bolstered by move-back-in trends and gen-Y appeal. Top core districts in these cities have become too pricey, so look in districts where "hip" residential neighborhoods meet commercial areas.

* Construct new-wave office and build to core in primary coastal markets: Major tenants willingly pay high rents in return for more efficient design layouts and lower operating costs in LEED-rated, green projects.

* Develop select industrial facilities in major hub distribution centers near ports, rail corridors and international airports: In these markets, the industrial sector is driven by tremendous demand by large-scale users looking for specialized space and build-to-suit activity.

* Use caution investing in secondary and tertiary cities: Focus on income-generating properties and partner with local operators who understand tenant trends and can leverage their relationships. Markets grounded in energy and high-tech industries show the most near-term promise, while places anchored by major education and medical institutions should perform better over time.

* Begin to back off apartment development in low-barrier-to-entry markets: These places tend to overbuild quickly, softening rent growth potentially and occupancy levels probably by 2014 or 2015.

* Consider single-family housing funds: Housing markets finally get off bottom and major private capital investors make a move into the sector. Concentrate investments with local players who know their markets and can manage day-to-day property and leasing issues.

* Repurpose the oversupply of obsolescent properties: Whether abandoned malls, vacant strip centers, past-their-prime office parks, or low-ceilinged warehouses, an overabundance of properties requires a rethink, a teardown, and, in many cases, a new use.

Investors Follow Job-Producing Markets and Echo Boomers

During recessionary times, some investors have sought more economically diverse markets to weather job losses and declines. However, now, in a time of slight economic uptick, Emerging Trends results indicate that investor sentiment is focused on job-producing industries and those markets that contain them, regardless of how diverse the businesses are that are producing those jobs.

The best housing markets, according to the report, will provide better commercial real estate options because a housing sector recovery generates more jobs, and demand for vacant commercial real estate. At the same time, banks will free up funding and a multiplier effect ensues. Even though the housing market is starting to improve, demand and interest in apartments in "American infill" locations remain attractive, leading to a boom in apartment development. Leading this cycle move is the echo boomer generation, which is delaying plans of home ownership.

Markets to Watch
A snapshot of the top five markets ranked by survey respondents and their outlook for each of the markets:
San Francisco (1). In 2013, San Francisco steals the Triple Crown from Washington, D.C., receiving top billing in the Emerging Trends investment, development, and housing categories. The market is driven by growth and a strong jobs outlook, led by technology and a structural change away from suburban and toward downtown. Continued infill interest is supported by providing one of the best transit systems in the country and a city center with walkability that is number two only to New York City.
New York City (2). New York City makes a small move this year, stepping up two spots to second best investment prospect. However, investors still seem concerned about the run-up in prices. Demographics for the city prevail, with 20 percent of jobs being in the growing education and health care sectors and an important echo boomer population. Service-type jobs continue to develop, but a lag in goods-producing jobs is a concern.
San Jose (3). The San Jose technology corridor continues to be a market to watch. In 2013, San Jose and the broader Silicon Valley are largely expected to generate jobs in a variety of fields, but most will revolve around the high technology firms. Industrial diversity is limited in San Jose and could be a concern for investors; however, the more than 6,600 technology companies based here employing over 225,000 people make it an area of interest.
Austin (4). In 2013, Austin looks set to extend its trend of attracting individual and institutional investors alike. Expansion of commercial real estate in Austin looks likely with a population increase of 2.3 percent anticipated next year, pushed by the echo boomer demographic.
Houston (5). Energy-related employment is one of the driving forces behind the Houston market and the investment prospect rank jumped from eighth to fifth. Survey participants believe the main buying opportunities are in the industrial sector - fifty percent believe that space in Houston is worth taking a chance on.
Rounding out the top ten markets to watch:
* Boston (6) has an increase in high-technology and biomedical research and development employment that continues to take the lead, increasing investor interest.
* Seattle (7) is the global center for the software industry and continues to be the focus of many domestic and global investors.
* Washington, D.C. (8) commercial real estate prices have risen since the recession, with investors regarding D.C. investments as "recession-proof;" however, concerns about overbuilding and costs continue to lead discussions about interest in D.C.
* Dallas/Fort Worth (9) ranks behind only Houston as a job provider, and the Dallas/Fort Worth job base is one of the most diversified of the 51 markets covered.
* Orange County, CA (10) shows increases in rating value and ranking as an investment prospect.
Property Types
Among property sectors for 2013, the survey finds that commercial and multifamily regain generally solid Emerging Trends investment ratings. Categories hold their relative rankings from 2012 in the survey, with persistent leader apartments still on top, though noticeably leveling off, and retail continuing to lag, but recovering. Industrial/warehouse and hotels show the biggest survey improvements, trailed closely by downtown office. Power centers and suburban offices remain investors' least-favored subcategories. Except for apartments and industrial space, development

prospects remain challenging. Interviewees show mixed concerns about apartment construction on a market-by-market basis, but generally concur that overdevelopment will happen, just not in 2013. They also anticipate more big-box industrial development.

Now in its 34th year, Emerging Trends is one of the oldest, most highly regarded annual industry outlook for the real estate and land use industry and includes interviews and survey responses from more than 900 leading real estate experts, including investors, fund managers, developers, property companies, lenders, brokers, advisers, and consultants.

A copy of Emerging Trends in Real EstateÂ® 2013 is available at www.uli.org/emergingtrends or www.pwc.com/us/realestate.

About the Urban Land Institute

The Urban Land Institute (www.uli.org) is a nonprofit education and research institute supported by its members. Its mission is to provide leadership in the responsible use of land and in sustaining and creating thriving communities worldwide. Established in 1936, the Institute has nearly 30,000 members representing all aspects of land use and development disciplines.

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