

## Commercial Real Estate

by Utah Business Staff

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With Downtown Rising beginning to ascend, regional malls undergoing reconstruction and redevelopment efforts in progress across the state, Utah is poised for significant commercial momentum and growth. While the real estate market has softened on the residential side, our panel of experts indicated that commercial real estate is holding steady. Noteworthy commercial developments coming on line in northern Utah County coupled with growth in eastern and southern Utah add to the state's historically strong retail and industrial markets. Our panel also discussed the impacts of the housing market, tightening lending regulations and opportunities in the suburban market.

Participants:

Chris Child, Marcus & Millichap; David Broadbent, Holland & Hart; Jed Millburn, ARA Utah; Fred Barth, Pentad Properties, Inc.; Don Whyte, Kennecott Land; Bill Martin, Commerce CRG; Steve Bogden, Coldwell Banker Commercial. Martin Lewis, Utah Business; Mark Bouchard, CB Richard Ellis; Steve Peterson, Millrock Development; Scott Wilmarth, CB Richard Ellis; Kyle Roberts, NAI Utah; Jeff Edwards, Economic Development Corporation of Utah; Gary Mangum, Coldwell Banker Commercial; Bruce Tucker, Prudential CRES Commercial Real Estate.

### **What is the current state of commercial real estate downtown? How is the City Creek project impacting what's going on?**

WILMARTH: I think downtown has a lot of excitement right now. We are looking at City Creek as being the impetus of bringing people back downtown. We saw a huge out-migration of tenancy during that time period when light rail and the interstate were being redone for the Olympics. But we see City Creek as being really the force to bring people back, both from a residential standpoint as well as an office standpoint. Now with the construction of 222 South Main, we are finally going to see some class A product that's going to accommodate some of these higher end corporate users that are looking to make a statement. 222 is really the office component of City Creek right now. City Creek is primarily residential and retail and someday probably will accommodate additional offices. This represents a great opportunity for our city to have a resurgence again.

CHILD: One thing we are seeing is that investors are looking at the Class C buildings in the periphery to buy them and turn them into Class B. I think that's going to really brighten the periphery and make the retail and residential sector work a lot better here in Salt Lake.

BOGDEN: We are in probably one of the most unique market scenarios in the United States. Every regional mall we have is under construction, redevelopment, being torn down or rebuilt. And the positioning of retail is going to be very interesting to see what happens in the next few years because of all of these changes. What they are doing in Cottonwood Mall certainly will have an impact on what happens at Fashion Place and such.

It's going to be interesting to see what City Creek does to The Gateway. They are both vying for the higher scale tenants, but City Creek has the same anchor tenants. There's no one new and unique, but it's

going to be an incredible development. It's going to be exciting to see what happens in retail in Salt Lake County.

BARTH: It's a very interesting market right now. As we drive through downtown, people are very interested to see all the construction and the cranes and a lot of movement. That's not something that is happening all over the country. The retailers that we deal with are moving from 2008 to 2009. Some are moving to 2010. That's creating an opportunity for local and regional tenants to fill that gap. Just the fact that so much money is being spent and that there's a lot of movement is creating a lot of excitement for retail, in spite of what you read and what you hear on the news. It's a very positive thing.

BOUCHARD: In the local community, we describe it as "City Creek" and "the [LDS] Church's project." Something that has been extremely understated is who the Church's partner is in the project - Taubman. This is a world class developer who has done some of the finest retail developments around the country, if not internationally. They have quite a following themselves because of the nature and quality of the projects they develop.

Real estate at its roots is still simply a business of great location and great opportunity with a blend of great demand in a marketplace. Utah represents the highest per capita purchase rate in retail of anywhere in the country. We spend more money in retail as a community, absent the Las Vegas strip, which is an anomaly in the world. You couple that with where we are economically compared to the rest of the country and any recession where Utah is concerned will be very shallow, very subtle, and I think we will come out of it fairly rapidly. In fact, I would suggest that we will be one of the first states out of it when we turn the corner. When that happens I think the momentum is going to be significant.

On the subject of The Gateway, I think this only adds to the strength of the downtown area. If you look at major metropolitan cities in the United States that went through this major transformation in the last decade, the region has lent itself to success for all phases of their development, from residential to retail to their condominium markets. The Gateway project is a well conceived, well developed project with strong tenants. That is an added value, because although you'll see some overlap, the reality is you're going to see a lot of new tenants from each project. In that situation, you're just going to have a greater array of services for people to be attracted to. When you have two to three billion dollars of new development with top-end developers participating, that partnership has got to lead to success.

MARTIN: I agree with what everyone said, but maybe look at it a little bit differently. Every single major project that Steve talked about and Mark talked about has leasing teams. They are all extremely good developers. These are not the smallest developers in the world. These are the largest developers in the world that are doing each one of these redevelopments. Every single one of them has teams out looking to try to secure tenants in a market in which the top 50 tenants in the world are not concentrating on opening new stores. They are concentrating on closing stores. It's a very unique time.

I think within the next year you are going to have to watch real carefully to see who gets what signed. It's good press for Utah because all these people are out selling the benefits of Utah, right? But anybody who owns those real estate projects is going to have to pay a lot of attention to buying those tenants because the high-end opportunities like The Gateway on the national basis are gone.

The same cycle has happened four times already now. You are trying to get rid of certain things that aren't making you very much money. When that takes place then everybody frees up their cash again and it will start moving.

On another note, I think it would be a good opportunity now to have our new mayor focus on the part of the city that hasn't been looked at very closely - Sixth South to 2100 South. You don't hear about that section very much, but it's a very good street, it's fast to get in and out of; it is close to the freeways in both directions. There's a lot that could happen in between those two sections that could remake that whole entrance into the city.

### **What impact will the large scale residential development have on this whole picture?**

MILLBURN: I think that the luxury condo market will be successful. Right now, the rental market is very tight downtown, especially with the newer products. I think occupancy rates are 98 or 99 percent. Rent per square foot is about \$1.40. So it's really tight.

As far as the high density component that they have there, I see it being a success based on the absorption rates on other projects.

There's also some other high density that is supposed to be going in over by The Gateway; approximately 500 new units are slated to go in. The real question is who is going to be the buyer of all of these condos. Are we going to attract people that have disposable income as opposed to entry level buyers that are in trouble with the sub-prime market? I'm at a loss to know exactly who all the buyers of all the condos are going to be, but I see it being sort of a composition of the eclectic crowd coupled with senior missionary couples. Overall, though, because of the magnitude of the retail component, it will probably be a real success.

WILMARTH: Some of the decision makers on the office side are telling us that they already have their eye on downtown residential housing. For the first time in their lives, they are at a place where they can actually contemplate a downtown occupancy, and they are thinking that a live-where-you-work kind of environment is pretty attractive. All the kids are gone, no more yard, that kind of thing. That hasn't happened in the 20 years that I've seen downtown. I think that's a pretty unique opportunity.

BOGDEN: I think you are going to see some of the boomer population want to have all this stuff in close proximity to where they live. Those of the LDS faith that will want to be close by all the activities and the temple and the meeting centers. I concur with [Wilmarth] 1,000 percent, I think those things are going to go like hotcakes.

MILLBURN: The affordable housing component downtown is really suffering. There were over 1,000 units that were converted from rent to condo, a lot of which was older product that was work housing. They are gutting some of the buildings built in the 20s and 30s, and they are putting in stainless appliances and marble countertops. It has taken a huge component of for-rent housing from downtown and there's good and bad that goes with that. To have redevelopment of the old buildings is great, but whether there is going to be enough housing to meet the needs of the workforce is a legitimate concern.

There's a parcel that I have been working on that's less than an acre and it's probably going to be sold for about \$5 million. When you look at price per square foot on the ground, it is staggering. It doesn't make any sense to do for-rent housing on it. It has to go condo. That's going to be the problem going forward, if it pencils out for developers to build for-rent housing downtown.

BOUCHARD: During the Governor's Economic Summit, Mark Gibbons gave an overview of City Creek and mentioned that the residential component of City Creek will have a for-rent component and an entry-level pricing component and another tier of higher end. The concern is going to be if we have too many people purchase these condominiums as a second and third home and the effect that will have on the retail component. The retail component can't survive between 8 a.m. and 5 p.m. It's got to have that evening component to it, that really work-where-you-live feel that's going to drive those retail numbers.

Obviously, as was discussed, the issue of for-rent housing in the greater Salt Lake boundary is somewhat limited. That's what happens in an economic cycle when you pour this kind of money into redevelopment. You start to push certain uses outside the periphery. I think for-rent housing, to an extent, is going to get pushed a little bit, simply because it's the natural order of things when you are developing real estate like we are seeing here.

Let's look statewide at what else is happening around the market. Last year there were a lot of positive things said about 2007 from a commercial point of view. How did 2007 turn out and what is 2008 going to look like from an overall state-wide perspective?

MANGUM: Our 2007 was stronger than our 2006. Nationally, Coldwell Banker has a large residential component to it as well, and overall, the residential market is down 20 percent almost on both coasts and in some of the mid markets. But we didn't see a downturn in the commercial business at all. We are on an up tick. As we visit with the agents and try to plan what kind of business is in the pipeline looking forward, we are looking for a stronger year in '08 than we had in '07. However if the first three months of this year are any indication of what we have for the rest of the year, it's a slowdown.

We are also seeing less speculative development happen this year. If you've got a spec project, you are going to have to be putting in a lot more equity this year than you did in previous years. It's kind of like survival of the fittest. You will see better, smarter deals that will come to market. All in all, we are still projecting a real strong 2008, but it started slow based upon what happened at the tail end of '07.

BOGDEN: 2008 doesn't look particularly robust, but it looks okay. 2009 is going to be another deal in the retail world. The mid markets are going to feel the pinch of some of the large tenant anchors like Costco saying, "We are going to hold back and if we have money to spend, we will go into the larger metro areas." So we see that as being significant. And as Bill [Martin] alluded to earlier, we have guys that are saying, "We are off the board, especially in the high fashion realm."

BARTH: Speaking to that, when we ask them why they are "off the board," they can't really tell you. We have had a number of clients that call us and say, "We are supposed to be slowing down, but our sales are up. Things are looking good. What's going on in Utah?" I think they are watching the news and they think that they are supposed to be doing certain things, but their sales and trends are telling them otherwise. It's like they want to use this economic discussion as an excuse for them to take a breather here.

MARTIN: Nationally, consumption is down. Maybe it's just an overall very large cycle. I think everybody is taking a breather on the consumption issue, and then they look at their charts and Utah is still doing well. I'm trying to draw the conclusion that all of our teams are out there selling Utah as a relatively positive place to do business. We still have in-migration, we still have positive family growth, family creation, and we have household increases where we are actually putting together households.

CHILD: I do a lot of business outside of Salt Lake City, and there isn't a recession right now in Cedar City. They have become the festival city. It is wildly successful. All kinds of commercial, retail and hospitality are going in there. Moab is overrun with European tourists. They have never had a better year. Logan continues to attract the prodigal sons and daughters of Utah; they are still buying homes there.

There's no doubt that sellers have to adjust their price expectations in terms of the risk premium. We call it a cap rate. The risk premiums have adjusted. They have gone from the sixes to the mid sevens and mid eights. But at the same time, especially in hospitality and multi-family, the properties are enjoying huge revenue increases. We have had rent increases in apartments which I don't think have even begun to start. The hotel industry has never been better in Utah. And we have had incredible growth in both average daily rate and occupancy.

**At one time there was discussion about a new, large convention hotel in this area. Any new movement on that that you've heard of?**

CHILD: We haven't seen that. The only thing we have seen is a spin-off from The Gateway, the Homewood Suites project, which is right next to the homeless shelter but is still doing very well. Investors have been very leery of the downtown area because of the retail and restaurant system just hasn't been up to par. All of the development has gone into Layton, which has done extremely well around Hill Air Force Base; West Valley City, all of that light industrial and industrial business down there created a lot of demand; and now moving out into northern Utah County.

ROBERTS: Industrially we don't feel a downturn. In fact, we probably see more development on the horizon in the next two years than we have seen in the last 15. A lot of it has to do with financing impact on rental rates. We didn't see the same kind of rental appreciation in the Utah industrial market that you saw in other western markets so you don't have a big peak to fall from. If you look at our real estate fundamentals for

industrial versus other western markets, they are stronger than anyone's except the inland empire of L.A. When you talk to the other servicing markets that have an effect on Salt Lake City industrial, they are not talking about cut and run. They are talking about having a couple of years of maybe 2 or 3 percent annual rental increases instead of 5 to 7 percent annual rental increases. So it's a pretty rosy outlook.

BOGDEN: In the peripheral areas of Utah, I think the big sleeper is the northeast part of the state. You will see Vernal, Evanston, and Rock Springs - that whole area where the tar sands could be overwhelming in the next two or three decades. And we already know that up in Vernal it's a boom town. That place is absolutely nuts.

WILMARTH: We see this year as being very robust. We are seeing deals getting done. We see more large users in the marketplace than we have seen probably in three years. We are seeing new product. We are seeing planned buildings going forward. But I think next year is going to be a little bit slower and that's primarily a function of this financial component. It's almost like it's a financial recession.

### **Let's hear about what's happening in the suburban market.**

PETERSON: There are certain pockets to the suburban market that are strong. It's about location, supply and demand. There are other parts down south that have a lot of product in the queue; we are going to see more concessions down there. Going forward, I think there's going to be a bit of a slowdown because it's going to take time to absorb what's in the pipeline. We need to be a little more choosy in terms of the projects that we pick and the type of products they are. In the suburban market there might be opportunity in the hospitality area for maybe a class A hotel, some little niches that aren't being serviced in that area. But if you look at the general office space, I think there's plenty of product on the books in the queue.

What we are also finding is that the smaller developer is going to have a tough time going forward because it is going to require more equity to be in the game. The larger developers that are well funded will be able to pick and choose and will have the equity to find the right projects, whether it's on their own land or other developments. But for the smaller guys, it is going to require more equity.

WHYTE: I think people are more selective about where they shop now. They want an experience at the same time. So I think places like City Creek and like The Gateway will tend to draw people even from some suburban areas like what we are developing in Daybreak. That means we need to shift our thinking in terms of land use in a suburban sense and make sure that we provide a different experience than what you get in the more regional kinds of facilities. We need to get more local. We need to be the place you go when you want to bump into a neighbor and sit down and have a chat over a cup of coffee. So we are steering our commercial in a neighborhood sense, to be more the kind of experience you would have in that kind of setting.

We are now seeing suburban rental becoming viable for the first time in 15 years, where we actually now can sell sites that would be used for rentals at a price that can compare with some of the for-sale product that has historically snatched away all the opportunities so people couldn't economically make a go of a rental.

I think we will be meeting some of the demand for rental, but competition is going to be much tougher for all of us. We are going to have to bring out our "A" game and perform in a manner that we haven't necessarily had to when the markets were all strong.

### **What are you seeing in Utah County?**

MANGUM: The development and growth in Utah County is pushing north. It's almost a coming together of the southern part of Salt Lake County and northern Utah County, and it's happening right out there at the Point of the Mountain. There's a major new reconstruction planned and money already allocated for widening of SR-92. Traverse Mountain has a major development that is underway with bringing that new outlet center. That will bring about a half million square feet of upscale fashion outlets. They are about 60 percent pre-leased on that development, with ground being broken this fall. There's also an office

component going in there. I see a merging of those two markets to where it is almost indistinguishable between Utah County and Salt Lake County.

TUCKER: I think northern Utah County, from Pleasant Grove to the border, is definitely filling in. Tremendous projects are planned and slated and we will see that create some hospitality opportunities that Utah County traditionally hasn't had in the past. I think the housing boom in northern Utah County drilled that price of dirt way up. We have lost some of those folks and it's bringing that pricing down to where it is realistic. And the competition has been shifted out a little bit.

BOGDEN: I think the retail component is strong in Utah County. If you bounce down the freeway, you go down to the Provo Towne Center. Across the street Boyer Company has a development. If you go to Springville, there are a couple of opportunities going in at the freeway outlet there. If you go down to Spanish Fork where Highway 6 and Interstate 15 join, Woodbury Corporation has a project there. And it continues in these off-ramps in the smaller communities, and it's going to continue down.

BOUCHARD: We are certainly bullish on the Utah County market. I think it's a longer term play when you take a look at the evolution of it, but there's certainly all the fundamentals there that would lead you to believe it is going to be a growing community over a long period of time. There are a lot of people that live down there that like living there. You've got an airport that is really underutilized and development opportunity around that airport that could be significant, especially in the industrial sector.

There will come a time that industrial will gravitate from this core California corridor and start heading south. We are seeing that moving to Draper with some quality projects. And you will continue to see that evolve further south. Certainly the Geneva Steel site is a very large tract of land, well positioned to the freeway, and has the opportunity to add economic development dollars and opportunity for employment in that market.

ROBERTS: If you look at what drives office absorption and industrial absorption in that market, there's a \$5 billion-plus nutraceutical industry. The reason I think you haven't seen a lot of speculative development down there is the nutraceutical companies consume that ground, and they are users and can pay more than developers can pay for it.

WILMARTH: I think a lot of our customers are recognizing that there's a labor force that was spawned from WordPerfect and Novell. There are a lot of good engineers down in Utah County. We are seeing a lot of our customers trying to push as far south as they can to marry management with this labor force that is more technical in nature.

**Any comments on Washington County? This is a county that has enjoyed a minimum of 4 percent growth for the last 12 years. Can they sustain that?**

BOGDEN: In Washington County, the airport is going to be huge. You'll be able to drop a 737 in there. That will open up transportation to Phoenix and other places that Washington County hasn't even thought about. I think you will see an industrial component that will go well there, because you are just up the road from Interstate 70 and you have some nice interchange.

BOUCHARD: Are they building enough apartments? You have a lot of people leaving Las Vegas and moving there and paying cash for their house. But where is that employment base going to come from to sustain the expansion of their economy? You have to have that element of entry-level housing that isn't \$350,000 for a house. You have to have apartments.

MILLBURN: There's a huge supply constraint honestly across the Wasatch Front and in Washington County. I think it's probably going to stare us in the face even more later on this year and in the next year. It used to be that Washington County was the only place that was in trouble as far as for-rent housing, and now it's really across the Wasatch Front that we are seeing that, as well.

There are a lot of buyers out there who are looking for high-density ground to develop. And honestly I have a few listings right now where it is staggering to see how much activity surrounds the high density

parcels. There are institutional developers from out of state coming and trying to find ground in Washington County and along the Wasatch Front that we haven't seen in over a decade. A lot of it goes back to the fundamentals of that market. You have to get a certain amount of rent to make it pencil, and you have to find the right location to make it work.

My guess is Washington County is probably in need of 1,000 to 2,000 units in a big way. But is there any big plan to deliver that? There are a few developers down there that have been doing a couple projects, but I don't see it being a real mass of new residential or rental product down there. And the same goes for along the Wasatch Front. There are a few projects that are going in in the southwest part of the valley.

MARTIN: Is it mostly restraint on zoning and community issues? Because you only built 380 units in apartments last year in the Salt Lake Valley. That's the lowest built in years.

MILLBURN: Our numbers are a little higher than that, but they are still relatively low. Again, the municipalities don't like it. The cities are still seeing what they hope is going to be there - high-end luxury condos or high-end homes. There needs to be some education as far as the cities understanding that you need to let some of these guys come in and build apartments.

I have a guy at my office who goes out to the cities to meet with the city planners and understand what parcels are zoned for high density so that we can take those to developers and say, "Here is a parcel and here is your chance to get in the market." He has only found three parcels where there is support from the municipality for for-rent housing all across the Wasatch Front. And some of the municipalities are saying, "We are okay with this but we want you to add another Gateway-style component along with it." It doesn't work. You need housing and it doesn't necessarily mean that you need to have high-end retail right next door to it.

CHILD: There is one constraint on financing. A lot of the apartment deals are financed with low income housing tax credits. Right now the buyers for the tax credits are damaged. They are the Bear Stearns of the world who bought those tax credits, and they are just not buying them. So that's going to make some existing tax credit projects have difficulty.

BARTH: I think one of the things we found over the years with retailers that are looking where to locate is that there's been typically a lot of cooperation in getting projects done here. And I think with the tightening up of lending and so forth, where sales have still been relatively strong in Utah, retailers want to come; developers want to build as long as the municipalities are willing to cooperate. Good deals will always be good deals. But the cities have to continue to cooperate with us to make it happen.

#### **Anyone else feeling that in terms of the municipal cooperation side?**

WHYTE: We definitely are. I have seen a lot of creativity shown by municipalities to try to help in terms of inducements for businesses to come into the area. Very, very aggressive help. As long as they know what is needed, they are prepared to sit at the table and explore what could be done, which is exciting.

BARTH: We have a number of California developers that have just given up down there. They said, "You know what, we have to come to Utah." In California, where it may take 18 months or two years to get a project out of the ground, they come here as a refuge in order to see some things happening.

Does anybody have anything they are really excited about? What are you looking forward to?

BOGDEN: I think green is going to be critical. I think you will see LEEDs in all governmental programs. The developers and brokers need to understand that, because it is going to start to be a requirement by various municipalities. Your costs are going to be high on the front end but over the term, all the residual effects of building green and going green in these buildings, I think it's going to be the hot button for the next umpteen years. And I think it will be critical for everybody to know that because some cities in certain areas and municipalities are already specing buildings, that you will meet these certain circumstances.

MARTIN: I think we all have to watch the housing, even though this isn't a housing discussion necessarily. What is the trend line on reducing our overburden of excess homes? We had 1,800 or 1,900 foreclosures in the Salt Lake Valley in the last six months. Las Vegas has 22,000. If you take the reference points, there's a big difference. If you watch the in-migration and housing creations and job growth, those three components will take off the housing issue as the prices go up on apartments. There's a transitional push to go from apartments into a house if the funding rate stays down and you can qualify. I think that's important because then you can tell the story about retail, you can tell the story about industrial and office as our economy continues to move forward.