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Mid-2003 yields full but mixed bag; one can find positives despite lack-luster economy

From a suburban, transactional real estate lawyer's perspective, the mid-2003 analysis yields a mixed bag of expectations for late-2003 and early 2004. In each area of real estate, one can find positives despite the overall lack-luster economy.

On the retail front, only certain specific retailers are still aggressive. Among this select group are well known big-box discount department stores, pharmacies and a lone convenience store/gas station operator. Otherwise, retailers appear to be moving forward cautiously. Moreover, in most cases, there are only two tenants in any particular category of goods (such as The Home Depot and Lowe's), whereas the early-1990 saw three and four operators in each category. New shopping centers are still being built, and opportunities exist in older centers with vacancies, but the deals take longer and retailers are wisely using their strength in current market to cut better terms for themselves. Despite the recent consolidations of local supermarkets, the grocery-anchored community center is still a very viable option, and small-shop space fills-in nicely with national and local merchants once the supermarket is on board.



The office market is still stagnant as a result of the over-development in late 1990. Local developers find it difficult to compete with REITs who have a higher threshold of pain when it comes to reducing rents and offering incentives. However, office developers are finding a new darling, even if it may be temporary. The extremely low interest rates have increased the appetites of office tenants to own their spaces, leading owners to create more office condominium projects in which buildings are either converted to condominiums or originally developed as condominiums. This trend is presenting opportunities to developers with land who were otherwise hesitant to build "spec" space. Local owners may find

themselves losing deals to neighboring owners who are willing to sell, as opposed to leasing. This form of ownership seems to be particularly attractive to medical users.

The mantra to residential developers is, and has been for the past several years, "I need more ground". With the record-low interest rates, residential ground is extremely scarce, and sellers are driving very tough deals. The term "option payments", which was rarely heard from sellers in the early 1990s, has become almost expected in today's climate. Still, the incredible demand and surging home values has managed to allow developers to finance these increased costs and keep the machine running.

The industrial market appears slow and steady, not really suffering from the ups and downs of the other sectors.

Some of the best news of the day is borrowing rates. Construction lending rates are incredibly low, with lenders often requiring a floor on a variable rate of 4%. Variable rates are now typically based upon LIBOR as opposed to the prime rate. At these rates, a developer's interest expense on a project is almost negligible compared

to prior years. Similarly, permanent fixed rates are below 6%, and, because of the slower pace of projects, permanent lenders are anxious to lend. With the low rates and the underperforming stock market, institutional investors have turned to real estate and have provided an additional source of funding to developers with completed projects.

The big negative in the market is the difficulty in getting projects through the development process. Municipalities are increasing resistant to development in the face of "urban sprawl" and local opposition groups have become more well organized and funded. In the past, a developer could plan on a 1 to 2 year development process, but developers are now wise to plan on two, three and four year projects in mid-2003, and it is not unusual for projects to take longer.

Overall, the market certainly has its challenges, but we see the mixed bag as being half-full for the coming year.

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