Opportunities Moving from Distressed Properties to More Normalized Real Estate

*Jim Butler**

This article reports on the results of a survey of nearly 200 California real estate professionals, gathering their views about the California real estate market and their expectations for 2013.

Nearly 200 California real estate professionals were recently polled about their views about the California real estate market and their expectations for 2013.

According to these industry insiders, there is a lot of good news to report. California real estate appears to be in the midst of a sustainable recovery. Survey respondents indicated that capital is more widely available than in recent years, and, for the first time since the housing bubble burst, developers are eager to commence project entitlements.

In terms of the real estate market in general, here is what was learned:

- 42% of respondents described themselves as "bullish."
- 55% described themselves as "cautious."
- 28% believe the market has already recovered; 43% believe the real estate market will achieve sustained recovery by the end of this year; 29% feel it will take at least two years to recover.
- 90% feel that acquiring debt will be easier or the same in 2013, while a similar percentage (89%) believe acquiring equity will be easier or the same.

Over 93% of respondents indicated being active in the distressed market. However, nearly 61% noted a material decrease in note sale activity, signaling that loan defaults are down and that large numbers of expiring conduit loans appear not yet to have created a second wave of defaulted note sales.

Movement from Distressed Properties to Stabilized Real Estate

Seth Weissman, a partner at Jeffer Mangels Butler & Mitchell LLP, noted that the survey results are consistent with what JMBM's real estate lawyers are seeing. Mr. Weissman's clients have been particularly active in the distressed market. "However, those transactions are giving way to more traditional 'market' deals as more conservative investors, looking to stabilized real estate as a traditional component of their portfolios, are re-entering the market," said Mr.

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Weissman. "As the overall economy improves and interest rates remain low, we are seeing increased activity in office, multifamily, and industrial projects as well as the upscale single-family market."

Multifamily

While cautiously optimistic about most sectors, our respondents indicated that multifamily is the most attractive market segment for investment. "Nearly two-thirds of our survey respondents are involved in some way in multifamily housing," said Benjamin Reznik, chair of the firm's Government, Land Use, Environment and Energy Group. "Demand for quality rentals remains very strong, and developers and lenders are eager to meet that demand."

Hospitality and Retail

A full third of the respondents are involved in the hospitality sector. These hotel investors and developers see that the stage is set for continuing improvement in hotel industry fundamentals and hotel valuations for at least the next five years. The market is also experiencing a renaissance of 'hotel-retail mixed-use' development, as retail and hotel developers both seek the increased revenue that is generated when the right hotel is added to a shopping center.

What's Coming Online?

Niche areas of development and acquisition that our respondents are actively involved in include transit oriented development (18%), creative office (16%), medical office buildings (13%), senior housing (10%) and student housing (nine%). "These unique infill opportunities have gained momentum for developers able to identify strategic development sites and seize upon demographic, transit or employment opportunities in local markets," said David Waite, of Jeffer Mangels.

Environmental Impact Reports and Entitlements

As projects get back underway, respondents are keenly interested in entitlements, but challenged by the process:

- While nearly 90% of respondents feel 2013 will be a good year to entitle or re-entitle properties, and almost half (49%) reason that zoning authorities will be more lenient due to lingering economic difficulties, we learn more as we delve into specific responses. As one respondent noted, this year will be "a good year because of cycle considerations, not an easy year." Another noted, "[g]etting entitlements is hard, and getting harder. Waiting just makes it worse."
- The picture on entitlements appears to dovetail with the general market sentiment. As one person said, "[e]ntitlement now is necessary for successful delivery into a robust market." Another noted that, "[m]arket demand for entitlement projects are high, and barriers to entry are difficult." A third agreed: "[e]ntitlement is still very hard, so new entitlement will add great value."
- A majority also suggest that applicants will be more aggressive with their applications, and 36% think projects will be approved more quickly because the pool of applications has remained small.
- Five percent of participants said they would face the challenge of preparing and circulating a new or updated environmental impact report (EIR) this year.

> "While the prospects for CEQA reform appeared promising at the end of 2012, expectations for meaningful reform should be muted as a variety of environmental stakeholders and special interests jealously guard their cherished seat at the CEQA table," said Mr. Waite.

Developers continue to be challenged by the entitlement process and realize that success may be buoyed by other factors, including the skills of qualified professionals. As one person wrote, "[a]pplicants who engage high quality land use attorneys and consultants have a much higher chance of getting projects approved."

David Waite agrees. "There are so many good projects in the pipeline that languish simply because they lack knowledgeable advisors willing to thoughtfully and aggressively engage with regulators to achieve positive outcomes," he said. "As development activity increases, having the right team of professionals in place will be more important than ever."