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Detroit's real estate leaders assess city's present, future

In the *Midwest Real Estate News* roundtable

By Mark Thomson
Staff Writer

Editor's note: In March, staff writer Mark Thomson traveled to Detroit to meet with local real estate industry experts in an attempt to analyze the greater metro market. In attendance were: Andrew Farbman, president and CEO of NAI Farbman; Steve Morris, executive managing director and principal of Newmark Knight Frank; Cameron Piggott, attorney at law for Dykema; Mark Woods, managing director of Signature Associates; and Randall Allman, first vice president with CB Richard Ellis.

Below are excerpts from the conversation.

MWREN: The downtown office market has experienced improvement in the fourth quarter and has outperformed many suburban markets. What are some reasons for an increased interest in downtown Detroit office property?

Farbman: Most of the deals that are getting done are getting done in subsidized buildings. Most of it is ground-up new construction, so the absorption numbers don't look the way that they should look. Unfortunately, or, fortunately, most of the users have demanded first-class space downtown and they see that as new construction. I don't think that is going to be, but it is supposed to be, a catalyst.

I don't think that there are too many big development sites that make a ton of sense for big corporations in the city. But it has been a catalyst and it certainly brings a vibrancy and it brings workers and retailers downtown. It brings corporate housing users downtown. All of it is a catalyst, but that being said, it doesn't really do anything to bring rental rates up. If anything, rental rates in the city are going down



Randall Allman of CB Richard Ellis, Andy Farbman of NAI Farbman and Mark Woods of Signature Associates.

right now.

I would say the other question is how does it relate to the suburbs and who wins and who loses? I don't necessarily think that there is a winner or a loser in this. The user that is going downtown historically has been a financial institution, a service company, or something related to General Motors. That has historically been it. This growth of new companies — the high-tech and companies that are focused on this urban, 24-hour scene — is certainly a new growth area, but it has never really been a lynchpin of the suburban office market in Troy or Southfield. Southfield has historically been a service-based market and Troy has been an automotive market.

Woods: I think that, not from a landlord perspective but maybe a service company perspective, we are spending more time with employers who have a much better understanding of the employee population pool that they need to run their business. Some know exactly how to do it and are sophisticated about it and some just have a good sense that the young people they need to get their company to move in the right direction — they know where it is.

Marketing Associates is a great exam-

ple of a company that went into a subsidized first-class office building. We were guiding them through all of their choices and it became clear that the people they needed and the best place for them to congregate was in a Class A building downtown at a competitively subsidized, renaissance, subleased zone. It was a perfect fit.

On the project management side, we are seeing that there are a ton of companies down there (Detroit) that are growing, like Caraco Pharmaceutical Labs, and they are looking for opportunities to expand their existing facilities and they are finding that it is still a good climate for them to do business in downtown Detroit. There is no winner or no loser. Caraco could have moved to Ann Arbor, would that have been a loss of Detroit? Probably not. You still would have had the expertise in the area, they just would have taken a bit off of what Pfizer has at surplus.

Morris: I want to touch on what you both said. It is easy to go on the negative, because that what the headlines are, but Caraco, Marketing Associates, Quicken and a few hundred other companies are growing and are very stable. When you go through them, they are doing just fine. They don't make the headlines.

You have a couple tenants at Oakbrook Commons. If you go in there, it is vibrant and there are young people. If you go to Ferndale you see a company called Big Communications. They have grown from 8,000 to 30,000 square feet. They are doing Web-based analysis for pharmaceutical companies. Does that ever make the headlines? No.

The bad news is we are so automotive and the good news is we are so automotive. All of us are doing business with the foreign suppliers who have made long term commitments. Daimler, when they broke off, leased 150,000 square feet on a 15-year lease. That was a long commitment. You have to look at the fact that we are going through a case study of restructuring in this state.

It's all the way from employment to the Governor's office. It is the restructuring of a Rust Belt state. Ohio is facing it. Indiana is facing it, but to a lesser extent publicity wise. We are the bull's eye for it. Everybody looks at the pain and they don't look at where we are going.

MREN: We have touched on a few things already. Let's talk about job growth. Your business obviously

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benefits from job growth. Michigan has a high unemployment rate. The state has some of the finest public education institutions in the world. You have the educated population, how can you start to spur job growth?

Woods: How many companies that go off shore to produce their products is it going to take for leadership in those companies to realize that it isn't that easy to make what they are making someplace else? When you add in all of the costs, forget about the \$1.35 an hour labor, this may be the best place to do business. I've got the Ford background. I've got the supplier-service background. I think it is going to take a full business cycle and people will realize that it's either cost, quality, ease of doing business, that it is just not that easy to do it (offshoring).

I don't think we are at where we are right now in the automotive industry because taking suppliers and making them build stuff offshore is working that well. Maybe it just takes a full business cycle to discover that this investment maybe isn't working that well and Michigan was a pretty darn good place to make these products.

Allman: I agree with him. I think that the skilled labor force is here. You have a great place to live and a great quality of life. I think that the state and the city need to diversify a little bit and not get so tied up in the automotive industry. We need to move some of those skilled trades in a different direction.

Farbman: I don't think we should forget the fact that there is more high-tech workers in southeast Michigan than anywhere else in the country, as far as having engineering backgrounds. The key to that is the spin-off. I think the state is more focused on the spin-off than it has been in the past. I think it is important. I was a big Mitt Romney fan, because he was really focused on at what point does the automotive industry look like the airline industry? At what point do we decide that this is an important industry? We need to support this industry for Americans' well-being and from a matter of safety.

Piggott: We are a state that in the middle of a significant restructuring. I think that the auto industry will always

be a large and important component, but we need to supplement it. You have to talk about things like alternative energy, life sciences, technology, advanced manufacturing. I think we have great infrastructure in terms of people, universities, water and fundamental pieces like that. All of those things have great promise.

I think the state has finally realized that they have to work their way out of this on a new basis and can't continue to rely upon the old economy. Sometime to go through a painful process like this is a necessary precondition to change. I think we have now started to turn the corner, but we have a ways to go.

MWREN: Will we see most of this activity slow down in 2008?

Farbman: There is a sector of our market that is active on the development side. You can certainly touch on the medical. We have an aging population. They are well covered for the most part. We have some of the finest medical institutions in the world. The transformation of the hospital is going on around the world and Detroit is no different. We are going to the single-room concept and outpatient surgical centers. All of that is extremely active in our market. There are opportunities for that kind of growth.

Allman: The mixed-use developments are hopping.

Piggott: I think we should talk about finance and the credit crisis. In my practice the banks are more or less out of business in most sectors. I think across the country you are seeing the securitized loan structures dried up completely. At one point they were constituting more than 50 percent of capital that was coming in to these areas. It gets complicated, but a lot of people who were supporting that were buying the lower levels of those securitizations and those don't exist anymore.

I think it will come back in the second half of 2008. It has gone from a lot of capital being available at very reasonable rates to no capital being available period. In a lot of these sectors the only buyers are people with money and they are driving prices down because they know they are the only show in town.

Farbman: If you look at the finance world it really has four pieces. It has the

local and regional banks, the CMBS, the insurance companies and then it has the international lenders. We don't get international lenders in Michigan.

Clearly there is a liquidity issue that we are all reading about. It doesn't change the fact that most of the commercial real estate, at least in the Midwest and southeast Michigan, is performing on that. When the loans were given we never had five percent cap rates. We were always an eight or nine percent cap rate market. If you have a deterioration in income it probably to the level where it isn't covering debt service.

Woods: There were some big gambles last year that were made in Detroit. Not just in real estate. Think about Cerberus. The investment community, the guys who know how to buy properties with cash, saw Michigan as an opportunity and took advantage of First Industrial exiting some of its portfolio and Liberty Property Trust exiting some of its portfolio. The money that came in was a gamble. I think they saw them as good investments.

MWREN: How is retail development doing in this market? Will it slow down with the housing market?

Farbman: I will say we have seen some retailers leave the state. Our firm has sold or released every one of our properties. Those were infill locations where there was still demand for that space. There was different ways that space could be used. The ground-up development or doing something in an outlying region is washed up because nobody knows what to believe on the population numbers. You don't know if it will fill in or not. That being said, the infill locations downtown Detroit really make sense.

Woods: We are seeing infill convenience work. By that I mean convenience food or convenience retail that is location driven. Luxury seems to be doing well. The in-between stuff, those are the places you go to spend time to save money: Home Depot, Wal-Mart, Costco, you are spending your time to go get to those places to spend money. There is plenty of that. They are well situated. The growth seems to be on the corners where someone will have a Potbelly's and a Starbucks. The neighbor-

hood shopping center where you have to re-tenant it is very difficult.

MWREN: What do you think 2008 will hold for the Detroit market?

Woods: I think it is going to be a great year. It's a perspective that I think is a bit unique. You've got service providers and owners right here. People need us more than they have ever needed us. We are busy. People have reasonable expectations. They may not be what they want their expectations to be. You might want \$170 square foot for the property, but if someone brings \$120, you will be reasonable. The huge real estate departments that use to exist in these companies don't exist anymore. They need outside service providers.

Morris: I think that 2008 will look exactly like 2007. I think the restructuring continues this year, but that is positive because we are reinventing who we are as a state. Corporations will still have an excellent opportunity to reduce their costs of operating business by negotiating with the new marketing level rent. I also think firms like law, accounting and architecture firms are fostering because their client base has been very proactive.

Piggott: As a service provider even in the real estate sector we had a very good year last year and we anticipate a good year (in 2008). We had one of our best starts ever this year. A little bit is different. We have done a lot of work for developers over the years and they are not as active. I'm optimistic in terms of the service provider industry. Real estate in general has a little ways to go. I agree that it will be a lot like 2007.

Allman: I agree with that. As service providers it will be a substantial year. Our services are needed. I think the restructuring that is happening now is just going to create more momentum for our individual offices. The Michigan economy is going to continue to struggle and the automotive industry is going to have to realign.

Editor's note: For a complete transcript of this roundtable conversation, as well as additional comments from attorney Cameron Piggott on legal issues facing Detroit developers, please go to our Web site at:

www.midwestrealestatenews.com