



## Commercial real estate's improving health exceeds forecasts

Updated 4/18/2011 11:20 AM |

By [Paul Davidson](#), USA TODAY

The once-dismal commercial real estate market is turning around far more quickly than analysts expected, with troubled loans falling, occupancy rising and office building sales surging in the largest markets.

That's welcome news for an economic recovery that still faces headwinds such as rising oil prices. The improving market has eased fears that banks might be crippled by heavy losses from their bad construction loans in the mid-2000s and would have to rein in lending just as credit is easing.

Lenders were still saddled with \$181 billion in distressed loans in February, according to Real Capital Analytics (RCA). But that's down from \$188 billion in September. Mortgage defaults for office, retail and industrial building loans dipped for the first time since 2005 in the fourth quarter, to 4.28% from 4.36%. They should fall further this year, says RCA economist Sam Chandan. "Worst-case scenarios have been avoided," he says.

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The recovery, he says, has finally stabilized building occupancy, letting landlords pay down loans. Vacancy rates in the first quarter dipped slightly for retail and industrial properties, to 7.2% and 10%,

respectively, and were unchanged at 13.4% for offices, according to [CoStar Group](#). Occupancy has edged up steadily since early last year.

Investors, meanwhile, are clamoring to buy well-leased office buildings in markets such as New York City and Washington, D.C. A big reason: virtually no new development the past few years.

In New York, "We're seeing prices (for prized buildings) return to 2007 levels" after falling 40% in the downturn, says Richard Baxter, vice chairman of real estate giant [Jones Lang LaSalle](#).

New York's biggest office landlord, SL Green Realty, has been scooping up buildings. Co-Chief Investment Officer Isaac Zion says credit is available, occupancy and lease rates are up and returns far exceed meager bond yields. "We really saw the writing on the wall and we pounced," Zion says.

Commercial mortgage-backed securities, a big funding source for some buyers, are up this year.

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More foreclosures are still likely to batter prices in many areas. But the investment furor could spread to cities such as Dallas, Denver and Houston, says CoStar senior real estate strategist Chris Macke.

Rising prices could at least temper foreclosures on the \$1.4 trillion in commercial mortgages that **Deutsche Bank** says are maturing by 2013. Even owners still making payments might not be able to refinance properties whose values fell sharply.

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