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Chicago

Industrial

"In 2002, decision makers were hesitant to pull the triggers on deals," says Tim Hennelly, vice president of sales with FCL Builders. The market did not see a lot of new deals completed, but there were some deals that were lingering and being repriced. One was a lease APL Logistics signed with Catellus Development Corporation. This 346,000-square-foot build-to-suit in Romeoville is indicative of a trend in the Chicago market. Third-party logistics companies were active in build-to-suits, with a number of deals done in the southwest corridor.

"In 2003, there will still be hesitation as we start the first quarter," Hennelly says, "but we are optimistic that developers will break ground on some projects in the spring." There are some new speculative developments ready to begin, but companies have restrained construction due to an excess of space.

As old product is leased up, there are two or three projects in the 700,000-square-foot range on the Interstate 55 corridor that will begin work. "The I-55 corridor will lead the market out of the downturn since activity has been going on in that area the whole time," Hennelly says. Due to I-55's southwestern growth, Interstate 80, including Joliet, Minooka and Mokena, should see early growth in the market. "We are optimistic that we will come out of the downturn when some existing space is absorbed and speculative projects get kicked off in the spring," Hennelly says.

– Tim Hennelly is vice president of sales with FCL Builders. The company will complete a 500,000-square-foot facility for CenterPoint Properties Trust in early 2003.

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Multifamily

In 2002, there has been a continuing demographic shift of residents. Empty-nesters are moving back to the city and younger couples are waiting longer before starting families. “The baby boom and the echo boom have become demand generators for the multifamily market,” says Greg Merdinger, a principal with The John Buck Company. That has translated into a demand for urban living estimated at a 23 to 26 percent increase in the urban population, because of the convenience and low maintenance in Chicago. If the growing population is sampled, the demographics would show they are the baby and echo boomers, says Merdinger.

In 2003, these trends will intensify in conjunction with a cessation of new product and an absorption of existing product. “The demand will continue, but the only question is, at what growth rate,” Merdinger says. There is an excess of supply to meet demand but the potential danger to developers of that situation is hard to predict. The answer lies in the time it takes to absorb the existing product in the system and the interest rates during that period of excess. If interest rates go up, there will be people currently holding real estate who cannot hold on. But if interest rates stay low and the system rights itself within 2 years, property owners will skate by.

– Greg Merdinger is a principal with The John Buck Company.

Retail

The Chicago retail market in 2002 was flat. Retailers across the board experienced a tough market, except for two exceptions. “Consumers are spending more around their homes, so home improvement has not only sustained itself,but increased business,” says Ross Glickman, COO of Urban Retail Properties Company.

Prominent retailers in that specific area have made their presentations more theatrical. “They’re fun environments to shop in," Glickman says. Restaurants are also seeing steady business since consumers view the dining experience as entertainment.

"But beyond that, I don't see anything on the specialty apparel side, the department store side, that's stimulating or exciting," says Glickman. "There's nothing on the horizon that grabs the consumer as a trend device."

"The amount or locations of new retailers coming to Chicago has been sporadic at best," says Glickman, who does not see any new national or regional retailers making a splash in the market.

As for 2003, the retail market's direction is cloudy." It depends. If there's a war, I think flat is optimistic," says Glickman. "If there isn't, I think flat is probably the best you're going to see."

– Ross Glickman is COO of Urban Retail Properties Company.

Office

"The downtown Chicago office market is suffering from a decline in corporate demand, resulting in excess space," says Charles Krawitz, first vice president in real estate capital markets group for LaSalle Bank, "not all of which has hit the sublease market."

The creditworthiness of tenants has become an issue. Over the years, a number of leverage buyouts have occurred and some tenants leasing today are not what landlords bargained for. Additionally, recent corporate scandals have raised creditability issues. The use of proforma vs. GAAP statements has raised concerns regarding the underlying financial strength of a number of large tenants. The thought that some tenants have weak or questionable financial statements that may not accurately depict their viability has weighed on property fundamentals. All of these issues are present, but sales volumes of office buildings in downtown are likely to hit around $2.3 billion in 2002. This is up from $1.3 billion in 2001 and $1.2 billion in 2000, making it the highest sales level since 1998, when it was $2.5 billion.

Some office buildings, like One North Wacker, are trading at $300 per square foot. This is occurring in a market where the downtown area saw a negative absorption of 4 million square feet this past year. Sales are up for a number of reasons. Low interest rates combined with low confidence in the stock market makes real estate seem comparatively attractive. Solid, stable ownership has prevented foreclosure activity that would bring prices down.

Investors see Chicago as a world-class market, such as German investors entering the market due to new tax incentives. Also $300 per square foot is less than replacement cost and prices in Chicago remain attractive compared to Washington, D.C., or New York City.

“The sublease space may be a positive attribute to building owners,” Krawitz says. The sublessor is subsidizing direct deals, offering building owners the opportunity to bring in new tenants with the cost of enticement falling on the sublessor.

2003 should not be any different unless the economy changes. Recent interest rates should help corporate bottom lines. Sales will remain high because of a lack of other investment opportunities.

– Charles Krawitz is a first vice president in the Real Estate Capital Markets Group for LaSalle Bank.

Office

Going into 2002, there was an optimism that things were going to move in a more positive direction. “Now there is a realization that the market is not going to make a swift return,” says Dave Petersen, a senior vice president and director of management and project leasing with Trammell Crow Company. “Our owners are challenging us with a mantra of ‘lease it and collect it.” In the first quarter, there was still a willingness to hold out for appropriate rent or longer term leases, but today occupancy is of critical importance and a priority for many ownership strategies. A significant shift in real estate buyers from past years has occurred. Individual private investors are paying healthy prices for properties versus a market more dominated by pension funds and foreign equity money, which, the latter, will remain a primary buyer.

Pricing is ticking up with the sales of the UBS Tower for $310 per square foot and 311 South Wacker for $275 million. The market will continue to be sluggish, though. Space will be available for the next few quarters potentially holding down rents and creating a significant subleasing opportunities. The market is going to remain weighted in favor of the tenant, so long-term leases are not right direction to go in all cases. Three- to 5- year leases will be more beneficial to capture the next cycle in the market.

– Dave Petersen is a principal, senior vice president and the director of the management and project leasing group with Trammell Crow Company.

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