Urban Land Institute Columbus

Real Estate Trends in Central Ohio 2014

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Center for Real Estate Education & Research

BACKGROUND

Real Estate Trends in Central Ohio takes a pulse of the region's real estate market, including capital markets, various sectors, and area submarkets. This survey complements the national Urban Land Institute's Emerging Trends in Real Estate, adding an in-depth local perspective to the national survey's insights on the U.S. economy and real estate markets.

In late September, ULI Columbus distributed a link to an online survey to its full e-mail list, from which 74 responses were collected from September 23 to November 1. Additionally, 15 interviews were conducted throughout October with key local experts from the private and public sectors across a range of professional developments, in particular real estate development, management, finance, and planning.

The information presented in this report comprise quantitative data from the survey and quotes from the interviews as well as the comment sections in the survey.

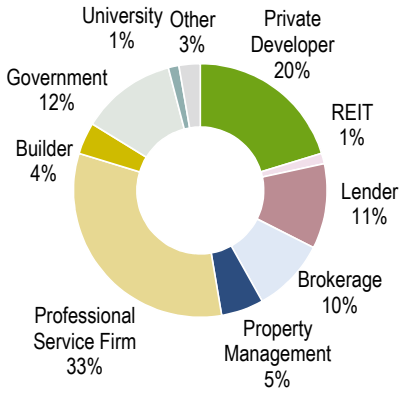
SURVEY RESPONDENT CHARACTERISTICS

Professional service firms represent the largest share of survey respondents at 33 percent, followed by private developers (20 percent) and government (12 percent).

More than a quarter (28 percent) of survey respondents are at the director or manager level at their firms. Generally, respondents range across different levels from CEO to Associate.

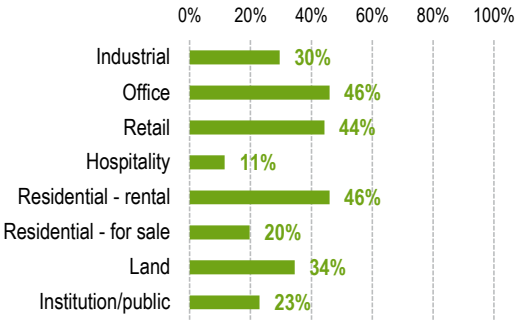
Nearly half of the respondents are involved in the rental housing sector (46 percent) and office (46 percent), followed by retail (44 percent).

Respondents by field

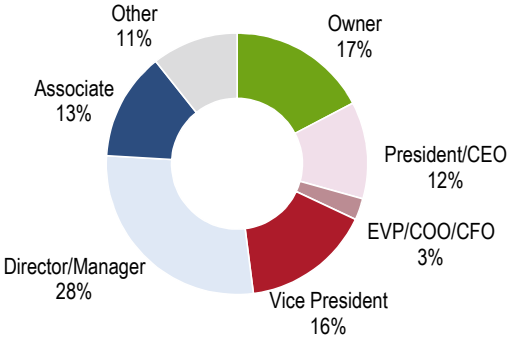


Other responses: property owner association, trade association.

Respondents by sector (multiple selections allowed)



Respondents by position



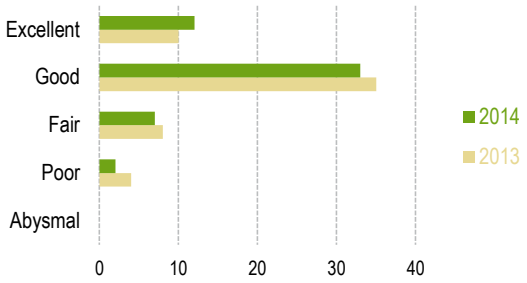
Other responses: administration of capital improvements, sales & leasing agent, planner, partner, marketing, business development, attorney, senior designer.

GENERAL BUSINESS PROSPECTS

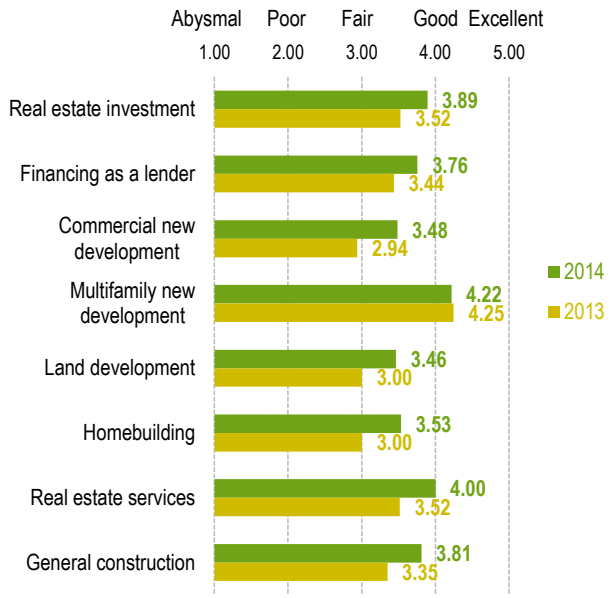
Survey respondents expect their own business to do slightly better in 2014 compared to 2013. Eighty-three percent of survey respondents expect profitability to be good or excellent in 2014, compared to 79 percent in 2013. These percentages are significantly higher than the 73 and 51 percent, respectively, from a year ago.

After years of strengthening existing portfolios, interviewees note better prospects across a broader range of sectors. "The hope is back. Opportunity is visible and achievable." Public-sector interviewees see more activity on permits and approvals. However, there is still a need "to be careful because the housing market is fragile."

Expected profitability of own business in 2013 vs. 2014



Business prospects for industry areas in Central Ohio



Among real estate industries, multifamily new development has the highest prospects in Central Ohio for 2014. The average rating of 4.22 (between Good and Excellent) is similar to last year.

Business prospects are higher across nearly all industry areas. "There's strength everywhere. Real construction activity is coming. In 2008, we stopped dead in our tracks. We're finally getting back to business."

Real estate services have the second highest average rating at 4.00, 0.48 points higher than last year. Commercial development and homebuilding have the greatest gains at +0.54 points and +0.53 points, respectively.

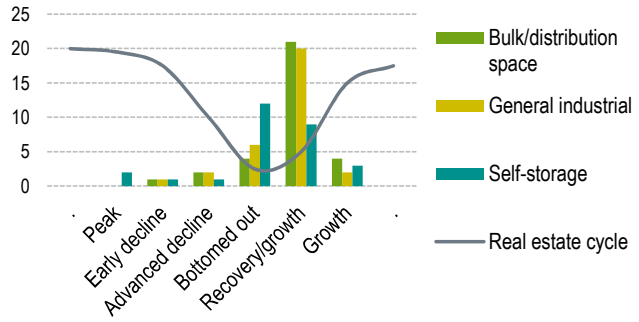
Interviewees have mixed sentiments on the pending comeback of single-family housing versus its long-term outlook. "Strengthening in traditional single-family may be the most significant" among all sectors. However, "ten years out, the relative number of buyers to sellers gets less favorable. Baby boomers will be selling in mass numbers." "The long-term rate of homeownership will come down."

REAL ESTATE SECTORS

Industrial

Bulk/distribution space and general industrial are now well in the recovery phase, whereas last year they were predominantly considered to have bottomed out. "Projects have commenced in 2013 and the pipeline for coming years looks positive." "If the economy stays strong, we'll see industrial warehouse on the manufacturing side."

Current stage of real estate cycle: INDUSTRIAL



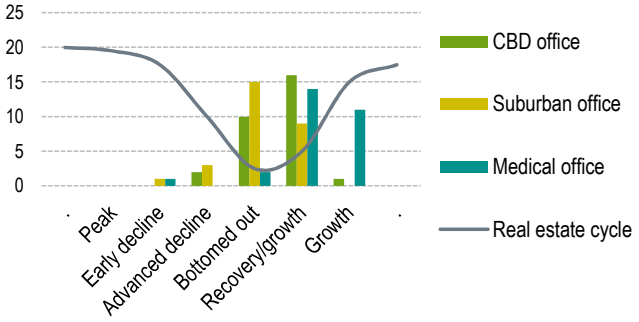
Office

In commercial real estate, medical office is shifting more toward the growth phase of the real estate cycle. As the Affordable Care Act is implemented, "the example we see from Massachusetts is that it produces millions of square feet in real estate need."

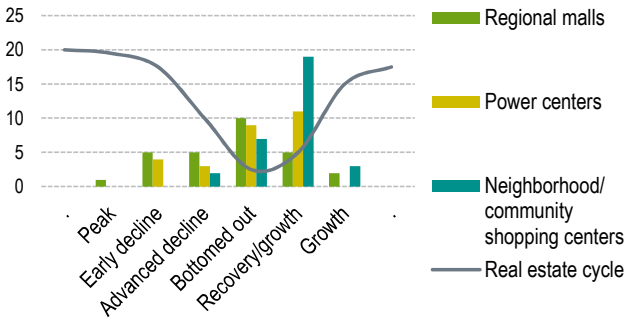
Downtown office is in the recovery phase, but suburban office lags behind. "Companies are cognizant of profitability. They are starting to hire more but are mindful of keeping overhead low." Build-to-suit opportunities will arise, but speculative development may be done for the long haul. "I don't think we'll ever do office again unless it's part of a downtown, mixed-use project."

The suburban office market, continuing to shake out, is "the only asset class that's not trading very well, even at low prices." "It's a matter of stabilizing what we have, taking the bottom properties off and improving the quality level."

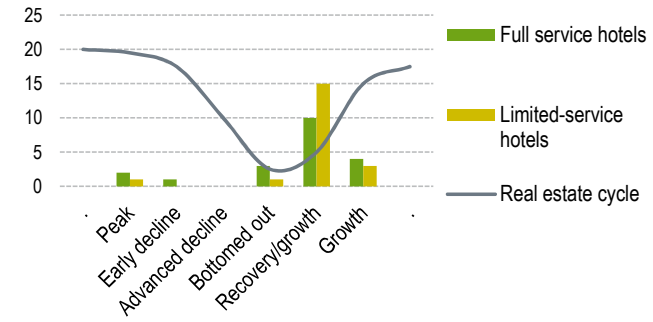
Current stage of real estate cycle: OFFICE



Current stage of real estate cycle: RETAIL



Current stage of real estate cycle: HOSPITALITY



Retail

Compared to last year's survey, neighborhood and community shopping centers have made a large shift toward to recovery. "Grocery-anchored centers have done best, holding up through the recession."

Assessments of regional malls and power centers remain about the same as last year, with most responses split between bottomed out and recovery. "Online sales are still replacing brick-and-mortar sales. Retail is not stable yet." With relatively little mall development, portfolios have "a chance to rotate our tenancy and pick up more rent."

In response to e-commerce, part of the new tenant mix is to "make shopping an experience, with restaurants, movie theaters, residential, office. More of a gathering place rather than commodity shopping." Health and wellness may become part of the experience, as "health systems begin to think like retailers, locating centers in high-income suburban markets."

"Big boxes are starting to come back in the market - Target in Powell, Wal-Mart in Westerville." But certain traditional anchors such as Sears and JC Penney present concerns.

Hospitality

Both full service and limited service hotels have shifted from bottomed out to recovery. A handful of survey responses place these sectors in the growth phase.

Rental housing

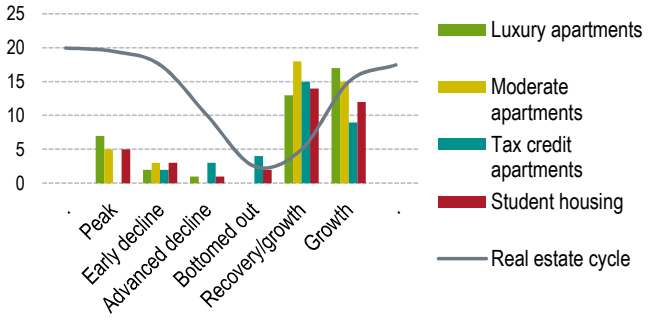
Rental housing is clearly in a growth phase, as it was last year. "We are in a boom, with high demand for apartment living in various parts of the city."

However, more respondents than last year are seeing the market peak and perhaps enter the early phases of decline. "Multifamily development continues to develop at a record breaking phase. It will have to slow." Developers "who are getting into apartments now could be late."

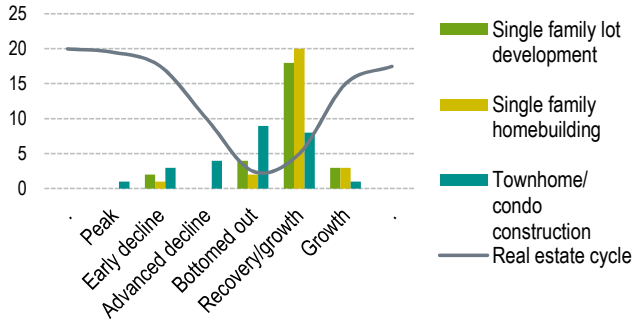
Any slowdown may be a minor speed bump from a broader perspective. "You may see overbuilding of multifamily rental in the short term, but in the long term that's where the sweet spot is." "The growth of one-person households is changing demand."

Multiple interviewees note senior housing as a growth opportunity. "The market has not fully addressed seniors who do not want to own a home, who want flexibility."

Current stage of real estate cycle: RESIDENTAL - RENTAL



Current stage of real estate cycle: RESIDENTIAL - FOR SALE

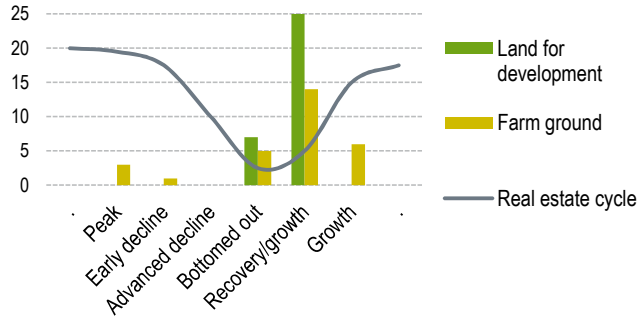


For-sale housing

Single-family housing has moved into the recovery phase of the real estate cycle. Two-thirds of respondents (67 percent) place single-family lot development in the recovery phase, compared to 30 percent last year. For single-family homebuilding, the figures are 77 percent and 39 percent, respectively.

Multifamily for-sale housing has not fully entered recovery, but a number of interviewees noted the beginnings of a shift from rental to condominiums, especially product geared towards empty nesters.

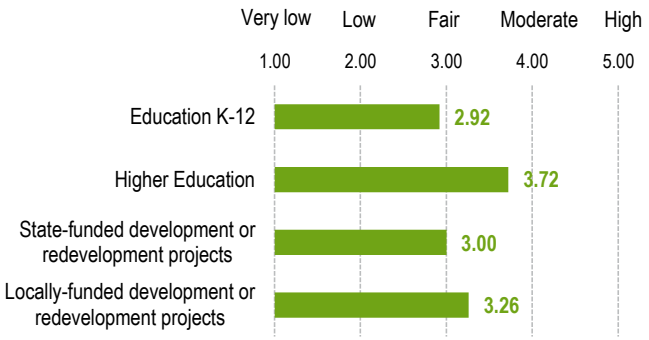
Current stage of real estate cycle: LAND



Land

Reflecting the recovery of land-intensive sectors such as new single-family housing and industrial, land for development and farm ground have also entered the recovery phase of the cycle. Nevertheless, it may be "a better time to be a land aggregator than a land developer."

Level of construction activity expected in 2014 for institutional/public real estate



Institutional/public

The expected level of activity for institutional and public real estate is similar to last year. Development for the public sector looks "flat to negative, maybe some projects in 2015-2016."

"Hospitals and the university have probably been responsible for 80 percent of the major construction projects in town in the last decade. We're going to have to see businesses take more of that burden."

Will employers follow urban housing?

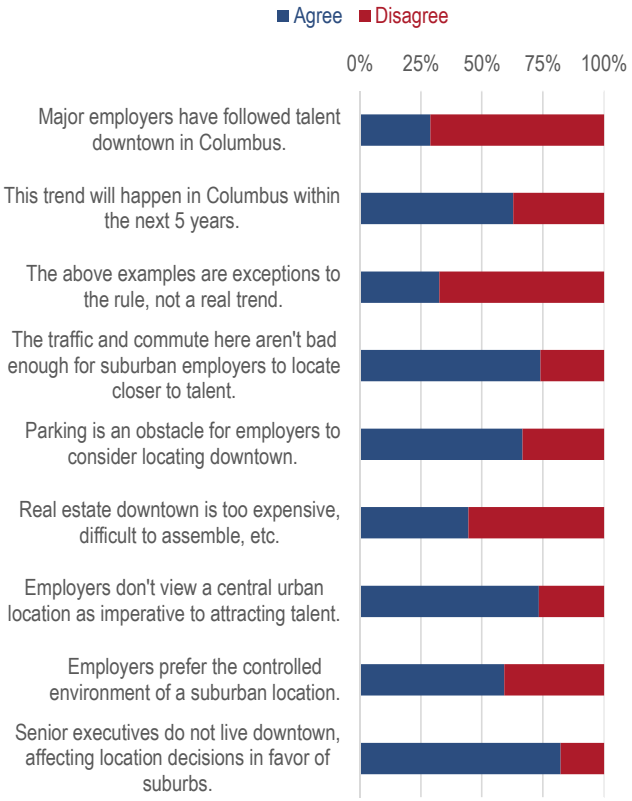
Preference for urban living, especially among Millennials, has yielded housing growth in and near downtowns across the U.S. One of the survey questions focused on recent corporate location decisions in favor of downtowns, where proximity to young talent was a major factor.

Two-thirds of survey respondents feel that the location decisions by firms such as UBS and Coca Cola represent a real trend. While only 29 percent believe that this has occurred in downtown Columbus, 63 percent think that it could occur within the next five years, "once additional downtown housing options become available." Perhaps smaller firms are already following talent: "We recently leased 60,000 square feet of office to various tenants, all coming from the suburbs. They noted that their younger workforce wants to live and work downtown."

The relatively short commutes in Columbus (74 percent of respondents) and downtown parking (67 percent) may inhibit a move downtown. However, management preferences could be closer to the truth. "Despite positive talk about our downtown, the political and business leadership haven't chosen, nor been challenged, to support this urban effort."

Central Ohio employers may not view an urban location as imperative to attracting talent (73 percent), and the fact that many senior executives do not reside downtown may be a deterrent (82 percent).

With greater interest in urban living across the U.S., other cities are seeing major employers follow their potential workforce and talent pool to locate in downtown (e.g. UBS in New York, Coca Cola in Atlanta, Amazon in Seattle, Zappos in Las Vegas). Please select whether you agree or disagree with the following statements.:



Capitalization rates

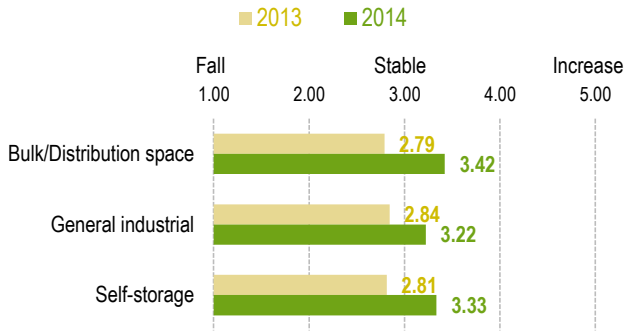
Capitalization rates for most sectors are considered to have remained stable over the past year, with average scores slightly below or above 3.00 (remaining stable). Compared to last year's survey, however, more sectors lean toward falling cap rates: industrial, retail, hospitality, rental housing.

Last year's survey had anticipated a modest cap rate increase across sectors. Similar to last year, stability is expected for the year ahead but with the possibility of a modest increase.

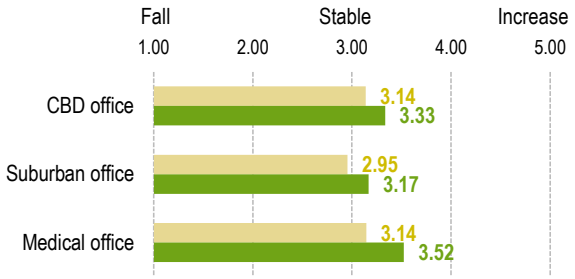
Industrial sectors have the highest gaps between 2014 and 2013 scores. Bulk and distribution space has an increase of 0.63 points. Self-storage and general industrial have increases of 0.52 and 0.38, respectively.

As anticipated in last year's survey, cap rates for office sectors remained stable compared to 2012. However, respondents see rate growth resuming for 2014.

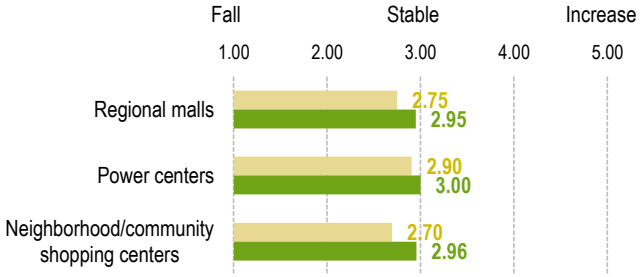
Cap rate trends in 2013 vs. 2014: INDUSTRIAL



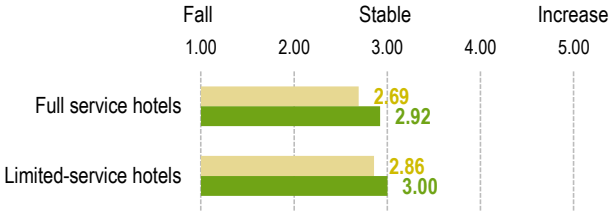
Cap rate trends in 2013 vs. 2014: OFFICE



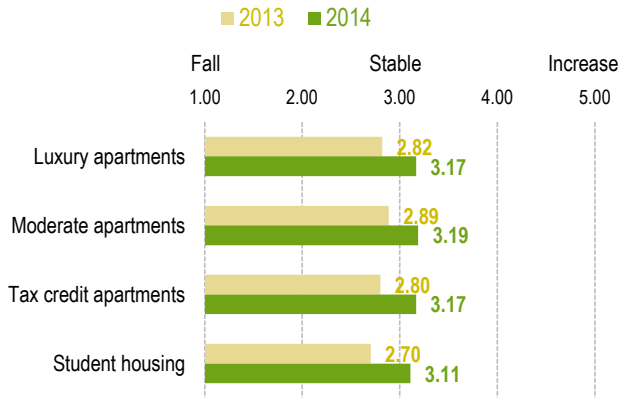
Cap rate trends in 2013 vs. 2014: RETAIL



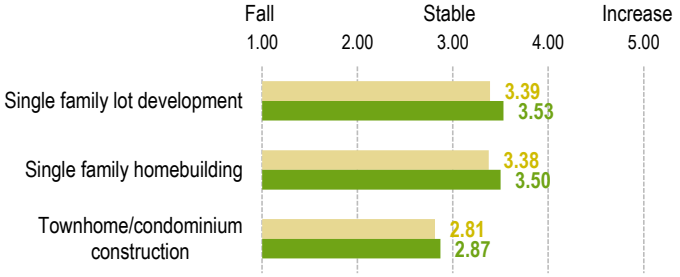
Cap rate trends in 2013 vs. 2014: HOSPITALITY



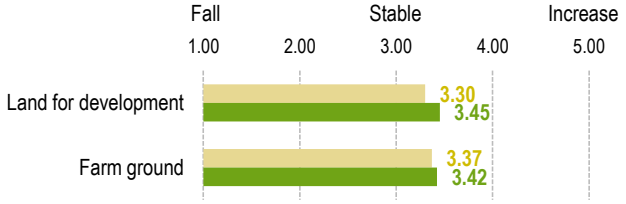
Cap rate trends in 2013 vs. 2014: RESIDENTIAL - RENTAL



Cap rate trends in 2013 vs. 2014: RESIDENTIAL - FOR SALE



Cap rate trends in 2013 vs. 2014: LAND



Survey respondents saw 2013 cap rate increases in single-family housing and in land development, more so than in other sectors, with additional increases expected for 2014. These figures contrast with last year's survey results, where cap rates for single-family and land were considered stable.

Relatively low cap rate growth is anticipated for rental housing. But for both the current year and the year ahead, rental housing cap rate scores are lower in this year's survey compared to last year's. "The cap rates are now between 5 and 6. We recently sold a project in Charlotte and the offers were at sub-5."

CAPITAL MARKETS

Inflation and interest rates

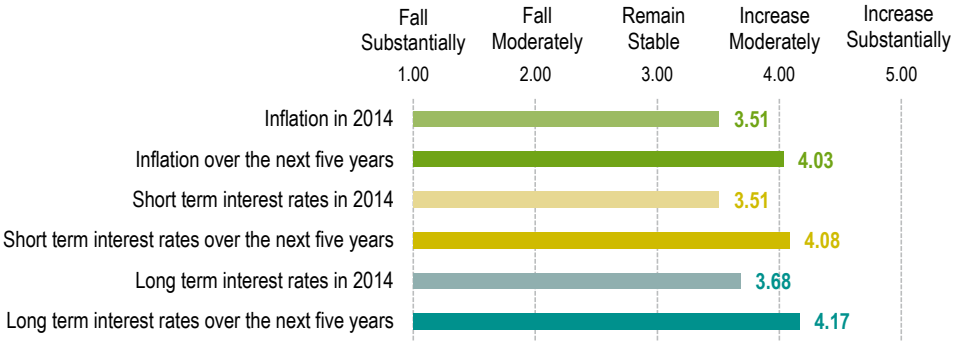
Compared to last year, survey respondents and interviewees see somewhat higher odds of increases in inflation and interest rates in 2014 and beyond. In the short term, "we see banks keeping rates down to remain competitive." "The spreads between what people are borrowing at to acquire or build projects and interest rates are still healthy." A greater threat in the near future may be ongoing federal budget battles: "Mistakes by the federal government could hurt business."

In the long term, "concern on where rates are going will drive a lot of investment now." For example, one interviewee noted that they "are applying conservative leveraging and locking in rates for 10 years wherever we can."

Low rates may be concealing other issues in the development area, such as rising costs. "As we get more projects going on, it's more difficult to keep costs under control. Everyone I'm talking to is up 10, 15, 20 percent. It looks decent with 3-4 percent interest. When you put in 8-9 percent, it changes dramatically."

Besides providing cheaper financing, low rates have also made real estate a more attractive investment option. "Everyone out there is chasing yield right now, and real estate is one of the areas where you can get real return." "Interest rates and bond rates are so low. Where else can you put your money to get a decent return?"

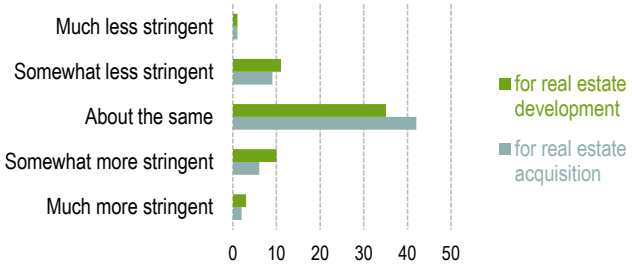
Expected change in inflation and interest rates in 2014 and beyond



Underwriting standards

Underwriting standards for both real estate development and acquisition are expected to stay about the same or become somewhat less stringent. Compared to last year though, expectations lean toward more stringency. In last year's survey, 28 percent saw underwriting standards becoming less stringent for real estate development, and 27 percent for real estate acquisition. In this year's survey, the figures are 17 percent and 20 percent, respectively.

Expected change in underwriting standards in next 18 months



Multifamily is of particular concern with regard to underwriting standards. "On the apartment side, things have gotten loose and there is plenty of money. With a few banks, I'm seeing some silliness happen. Memories are short." At the same time, other "bank lenders are looking at how heavily invested they are in rental housing." On the other hand, "the condo market's got a ways to go. It's difficult to get buyers financed for condos. Underwriting standards for condos are more difficult than for single family." In commercial sectors, "underwriting standards are still diligent," with "attention to other activity that the developer has going on."

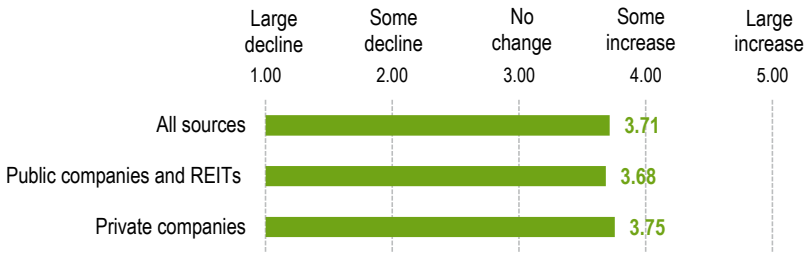
Capital availability

As they did last year, survey respondents again expect to see both equity and debt capital to be more available in the upcoming year. Equity investors "feel they can dictate terms, and the return hurdles are high. While we're saying 'the market's moving, you're missing the boat.' We're going to start seeing equity terms go in favor of the developers, because people are having a hard time finding good opportunities."

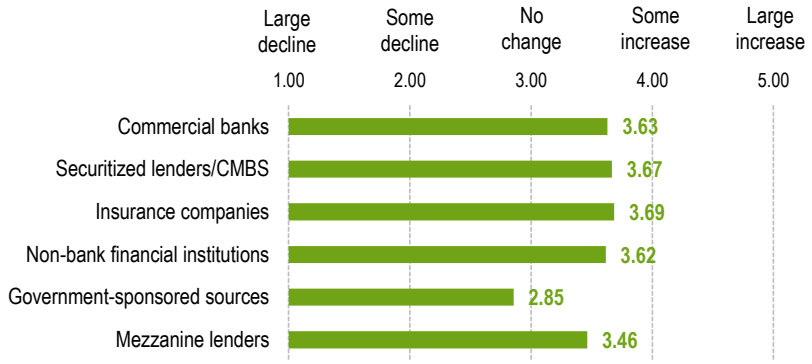
Equity maintains an edge over debt in terms of availability. "There are REITs and other sources of capital that are anxious to see further development." But the gap between equity and debt is closing, with "more competition to invest and finance projects. We have a tremendous amount of interest from banks and insurance companies."

For most sources of debt capital, especially securitized lenders and insurance companies, availability is expected to increase in 2014 as much as it is for equity. "Institutional capital is readily available, but it's a bit more expensive with more strings attached." Meanwhile, debt capital from mezzanine lenders and government-sponsored sources continue to lag.

Expected change in equity capital availability in 2014



Expected change in debt capital availability in 2014



CENTRAL OHIO SUBMARKETS

Best prospects for 2014 and beyond

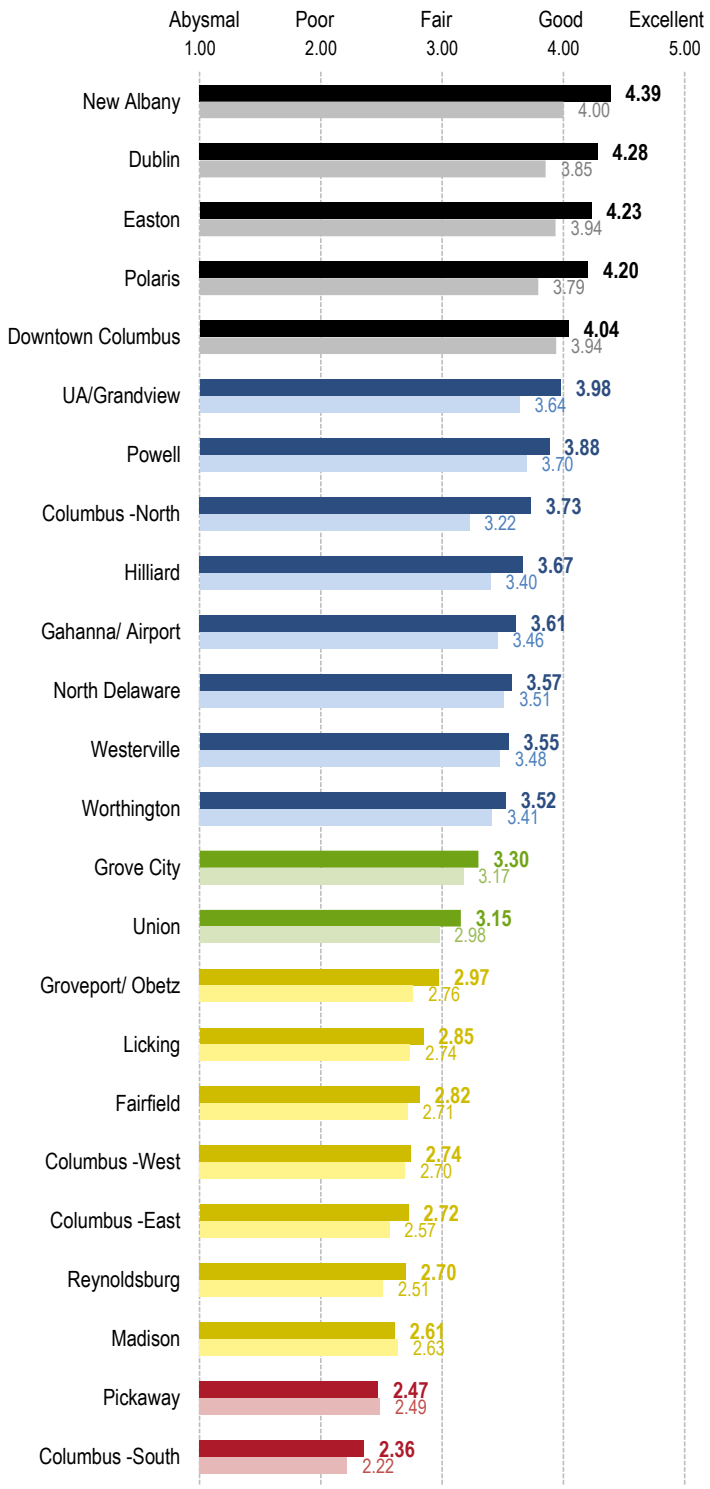
For the second year in a row, New Albany has the best prospects in the region for real estate activity in the year ahead, with a rating of 4.39. Dublin, Easton, Polaris, and downtown Columbus also achieve good-to-excellent ratings.

Several interviewees highlighted the arc of suburbs from northwest to northeast, between "10 and 2" on the clock dial. "Dublin has the Crawford Hoying project and two other large mixed-use projects - the transformational quality is equivalent to Muirfield." In contrast to overall sentiments on the sector, Dublin is "starting to see more office interest."

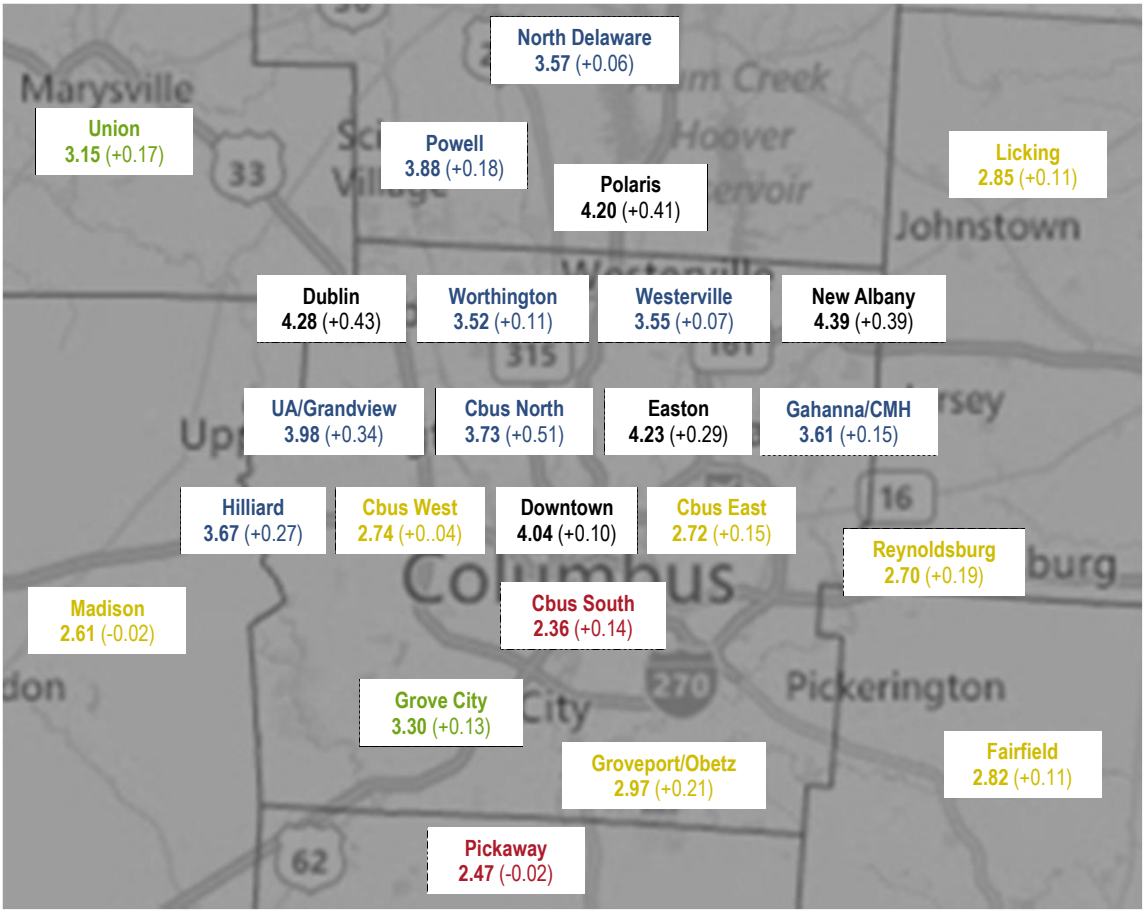
Consensus is emerging that "downtown is past the tipping point. All the initial efforts will start to pay off and snowball." "We're getting to that point where downtown is not just a niche. It's going to become a fully grown up neighborhood, not just alternative living."

"Easton is intriguing because you have a strong developer with product that's really good, and everybody forgets they've only built out half the office space. They're not going to sit still. There's a lot of potential."

Prospects for Central Ohio Submarkets in 2014 (vs. last year's prospects for 2013)



Prospects for Central Ohio Submarkets in 2014 (with change in score from 2013 prospects)



Prospects elsewhere in Central Ohio

The north side of Columbus is the biggest gainer over last year with a 0.51 point gain in prospect ratings, reflecting the potential of infill development. "Being inside 270 and going to these suburbs that are landlocked, that's where real opportunities are going to be made." "Suburbs are trying to adapt to what they see as an emerging urban form of development." "The most economically viable multifamily projects will be those located in the urban core or older subdivisions with good school districts." "The level of interest in denser, mixed-use development has grown dramatically, stuff that people five years ago wouldn't propose in most places in Central Ohio."

The success of downtown and surrounding neighborhoods such as the Short North and German Village will push out the development frontier. In the Short North, "pricing on the High Street corridor makes it hard for certain types of projects. Things are starting to move to Summit and 4th streets. When Wagenbrenner's project [in Italian Village] comes online, that will be powerful." "Folks have already jumped on the prime sites. For more pioneering folks, it may be Weinland Park." Or perhaps Franklinton, where "someone has to have the courage or the foolishness to take the plunge." With rental housing for instance, "instead of the $1.60-1.70 [per square foot per month] rents up in Columbus Commons, it may be closer to $1.15-1.20" for newly emerging areas like Franklinton.

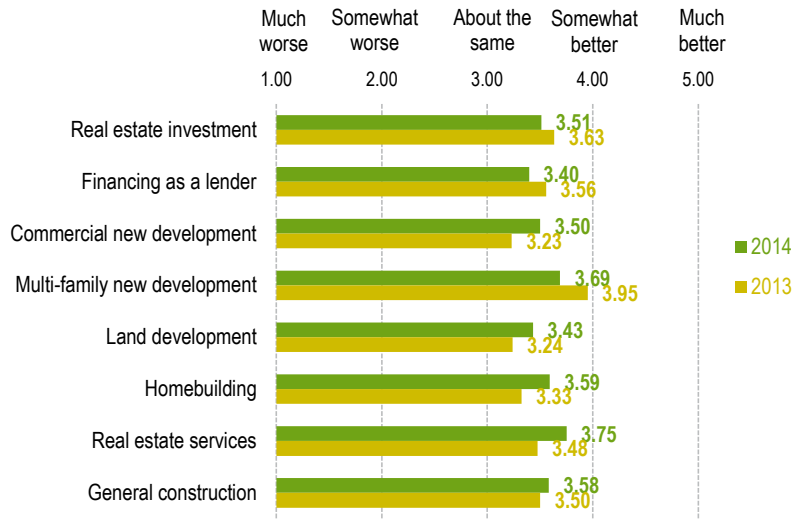
HOW DOES CENTRAL OHIO COMPARE?

Industry areas

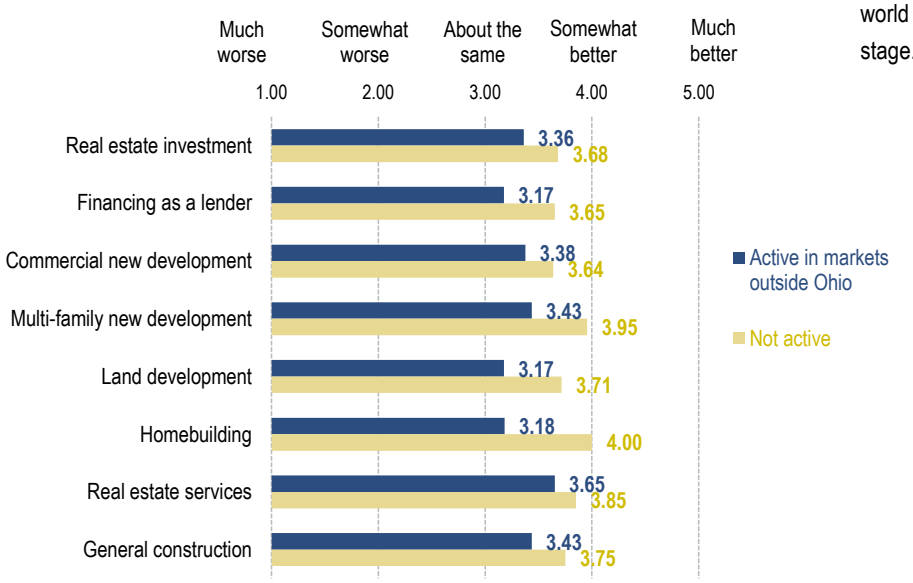
Survey respondents on average feel that Central Ohio is doing as well as, if not better than, most other markets. Real estate services rates the highest (3.75), followed by multifamily new development (3.69) and homebuilding (3.58). Real estate services, commercial new development, homebuilding, and land development have higher scores this year than they did last year. Multifamily new development and lender financing have lower scores.

Respondents who are active in markets outside Ohio are more critical than those active only in the state or in Central Ohio. Residential-focused sectors - homebuilding, land, and multifamily - have the largest perception gaps between the two respondent groups, at 0.82, 0.54, and 0.52 points, respectively.

Central Ohio compared to other U.S. markets by industry area



Central Ohio compared to other U.S. markets by industry area
(respondents active in markets outside Ohio vs. not active)



Compared to Sunbelt markets, "Columbus has always been a moderate-growth city. Most of our growth is organic. The Phoenix market has more growth from the outside." "New development is in markets with better tax structures, growth, climate."

Other opinions are more positive. "Any time we have an investor come in this market and start understanding it, they're pleasantly surprised." "Markets such as Texas and Florida are recovering much quicker, but we are doing well."

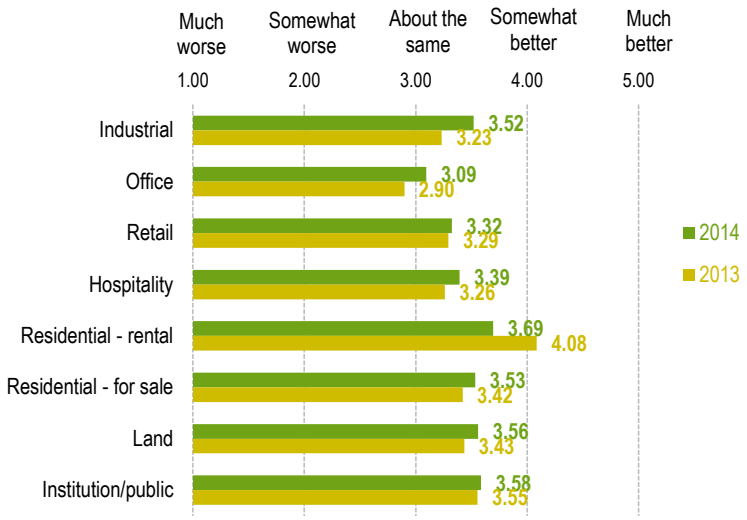
Ultimately, rather than "being good enough," Columbus will "need to be able to compete on a world stage and not just an Ohio stage."

Sectors

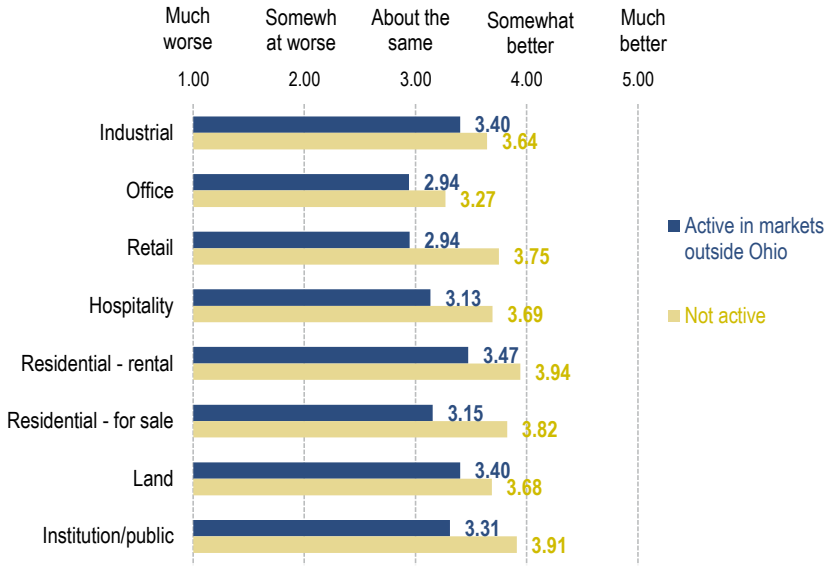
Central Ohio is seen as a relatively good place to do business across real estate sectors. Rental housing leads the pack with an average rating of 3.69, although this is down from the sector's 4.08 score last year. This reduced score relative to other U.S. markets, with the sector entering the peak phase of the real estate cycle and seeing lower capitalization rates, indicates that local opportunities for apartment development may not be as "easy" as it has been the past couple of years.

The gaps in scores between respondents who are active in markets outside Ohio versus those active only in the state or in Central Ohio reveal a significant hometown bias. Respondents active in outside markets rate Central Ohio as slightly below average for retail and office, in contrast with their counterparts who are active exclusively in state.

Central Ohio compared to other U.S. markets by sector



Central Ohio compared to other U.S. markets by industry area
(respondents active in markets outside Ohio vs. not active)



Land use and development needs

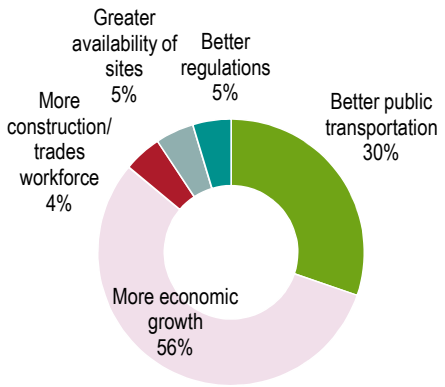
More than half of the survey respondents (56 percent) believe that more economic growth is the greatest need for the region's real estate development. "We need economic growth. Columbus has moderate growth, but that's not enough." "The growth in Central Ohio tends to be companies already here growing. One of the challenges is making it attractive to outsiders. You just don't have the relocations here that you do in other places."

Public transportation is also seen as a major need (30 percent of respondents). "We need more transit options to go with the growth of businesses and residential units." In central Columbus, "some kind of circulator is needed to integrate from the university to the county complex." Even on the matter of downtown parking, an interviewee responds that "we have a car problem. How do we do with less of them? Parking is part of the solution, but the challenge is how to move people more efficiently."

The issue of development regulations draws mixed responses. Some are critical: "We need faster permitting to facilitate risk takers meeting the emerging markets." Others believe that Central Ohio is neither more challenging nor easier compared to most other markets. "Columbus is a good city to work in, with relatively central decision-making." Downtown receives kudos for their development policies: "Columbus is doing an excellent job of promoting development in the urban core. The downtown commission is the best planning group we've worked with in the country."

On workforce, "construction trade hiring has been a problem, but more at the beginning of the year than now." "When you talk to general contractors, there's a shortage of good quality subs who are capitalized and can stay in business. A lot of good subs that we've worked with are no longer in business."

What is Central Ohio's biggest need for land use and development?



The long view

"I try to be in 2050. 2050 is like 1980 to today. It sounds like forever, but it's the same timespan."

Several interviewees express concern for the region's long-term development. "How the next 400,000 Central Ohioans locate themselves will have a lot of impact. The region will have to plan for the empty nesters, what one-person households want, what a diverse population wants." The region needs "transformative infrastructure projects." "There are many different ways something can be done – density, sustainable energy, water usage, transportation. You have to sit down and think carefully about what kind of infrastructure development model is the most effective one for economic development."

In addition to regional development and infrastructure, interviewees highlight the issue of urban education. "A community is going to suffer if it has an inadequate school system. We need to sort out the problem with Columbus City Schools. Without good schools, you're not going to get economic development."

Within the real estate industry, it will be interesting to see how these challenges are tackled with "the emergence of the next generation of developers. You see the old guard kind of adapt, but then you see the newer developers and where things are heading."

PUBLIC-PRIVATE PARTNERSHIPS

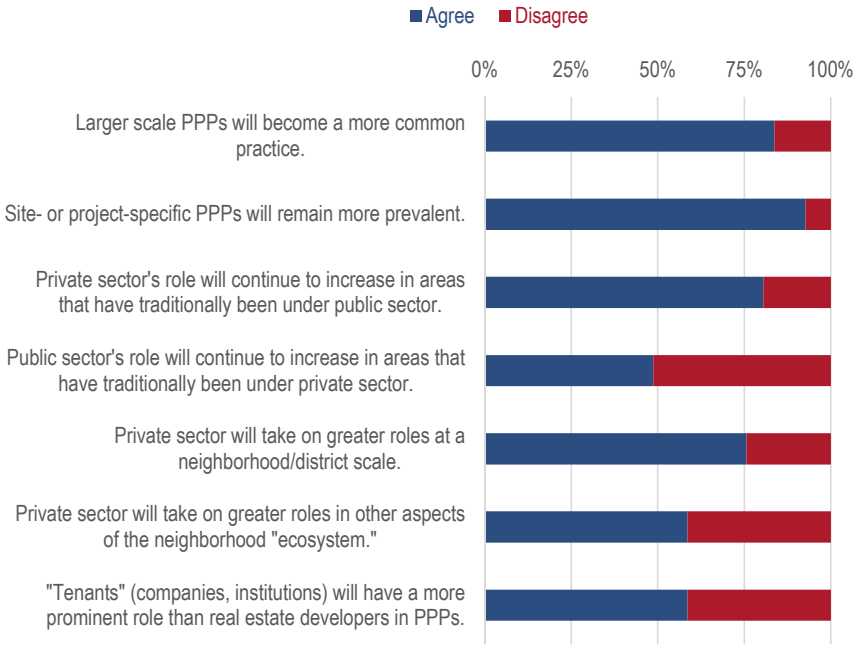
Nationwide Children's Hospital has had an active role in their surrounding neighborhood's revitalization. OCLC has been a key part of Dublin's Bridge Street corridor planning. Columbus Commons and Scioto Mile included significant private investment. This year's survey asked respondents how these cases might signify the evolving nature of public-private partnerships (PPPs).

The general consensus is that we are seeing more larger PPPs (84 percent) but that site-specific PPPs will remain more prevalent (93 percent). "More than ever it's an upfront planning exercise." "Governments are not built to make strategic investments in real estate without having a private sector partner that has a profit motive and assumes appropriate risk. How do you close the gap between the market, how far the developer can go, and potential, what the community wants? You can't think about development without thinking about public-private partnership."

In particular, the private sector is expected to take on greater roles in functions that have traditionally been under the public sector (80 percent) and on a neighborhood- or district-wide scale (76 percent). "PPPs will expand in areas where it hasn't been done before." Fewer respondents foresee the public sector take on greater roles in functions that have traditionally been under the private sector (49 percent). Nevertheless, the public sector will be heavily relied upon for "parking facilities, urban street patterns, and other amenities" as well as for "financial input on projects to go forth and be maintained."

Perhaps looking further ahead in the future, 59 percent of respondents believe that the private sector will become more active in other aspects of development such as business incubation, education, entertainment, and the provision of other non-traditional services. A similar majority believe that the private-sector side of the equation will be more driven by the companies and institutions tenanting the buildings rather than the developers who build them.

How will PPPs change in the future?



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