

FEATURE ARTICLE

# OUTLOOK ON 2015

BIG SUNBELT METROS EXPECT ALL REAL ESTATE SECTORS TO DO WELL IN 2015, WHILE SMALLER CITIES RELY ON KEY INDUSTRIAL AND RESEARCH SECTORS TO SPUR GROWTH. THIS YEAR WAS PHENOMENAL FOR COMMERCIAL REAL ESTATE AND EXPECTATIONS ARE FOR A BETTER 2015.

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By Steve Bergsman

In the third quarter (2014), German pharmaceutical giant Merck KGaA announced it was acquiring Sigma-Aldrich Corp, a St. Louis life sciences company for \$17 billion.

## THE MIDWEST

St. Louis often gets lumped in with other, older, Midwest industrial cities, but it has been quietly thriving as a vortex for botanical and medical research. “In the coming years St. Louis commercial real estate expansion will be primarily in the medical field,” observes **Sheldon Johnson, SIOR, CCIM**, executive vice president of the Johnson Group Inc. in St. Louis.

The Donald Danforth Plant Science Center attracts scientists from all over the world who conduct experiments on botanical-based chemicals that can be used for the medical and pharmaceutical industry. In May, the Danforth Center announced a \$45 million, three-story expansion to house an additional 100 researchers.

While a handful of major Sunbelt cities will experience rapid expansion across almost all commercial real estate sectors in 2015, smaller cities in the Midwest and Southeast such as St. Louis and Knoxville, Tenn., will also do well capitalizing on niche industrial and research sectors. Despite limited populations, these latter cities have carved out sectors of expertise that will help the local industrial and office markets expand in the coming year.

The center of research and industrial expansion in St. Louis has shifted to what is called the Cortex Innovation Community, a joint project of Washington University, BJC Healthcare, University of Missouri – St. Louis, St. Louis University, and Missouri Botanical Garden. Since its inception in 2002, Cortex has completed, or has under construction one million square feet of new and rehabilitated space, totaling \$350 million in investments.

“Expansion continues in this area as well as in neighboring parts of the city,” reports Johnson. “BJC Healthcare built a 130,000-square-foot facility in the area and the St. Louis Children’s Hospital is relocating there from elsewhere in St.

Louis County. Last month the federal government approved money for a new MetroLink train station at Cortex.”

“The growth has attracted to the area new retail, including St. Louis’ first Ikea and multifamily,” says Johnson. “Plus, its expansion has meant a geographic linkage to the nearby St. Louis University campus and the hospital district, both of which have seen significant expansion. In the latter, local hospitals are investing in new structures to the tune of about \$1 billion,” Johnson adds.

All that investment is and will be within St. Louis city limits. Asked if any expansion has been going on in the suburbs, Johnson says he has been very busy with investment deals, including a just

completed lease for a LEED gold-standard building that he then sold to an investor, and the sale of a 16,000-square-foot building sold to a Missouri company expanding into St. Louis.

Some spec development has started in the St. Louis suburbs across the Mississippi River in Illinois. “On the Missouri side, any new construction would be build-to-suit,” says Johnson. “If activity continues we might see some spec toward the end of 2015. People are talking about it.”

While St. Louis has gotten a boost from its life science and medical research centers, the Knoxville/Oak Ridge economy stands on solid footing due to all the Department of Energy National Laboratories in the region — as well as from medical industry expansion.

“We see a lot of government work coming here as well as spin-offs from the National Labs,” says **John Adams, SIOR, CCIM**, founding principal of Cushman & Wakefield/Cornerstone in Knoxville, Tenn. “DOE has a huge presence here and with it comes a lot of technology, security and research. They did the first 3-D printing of a car in Oak Ridge.”

He adds, the National Labs and spin-offs “continue to back-fill space.”

The industrial and office market in 2013 was good in Knoxville, says Adams, “but 2014 was phenomenal; so 2015 will be interesting.”

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One of the trends in Knoxville has been a steady flow of outside investment money coming into the commercial real estate sector. “Most are first time investors to Eastern Tennessee, private equity and large companies trying to diversify portfolios,” Adams explains. “They have been priced out of Southeastern markets like Charlotte, Atlanta, and Nashville; they like the steady economy we have in Knoxville. That has been a big driver of our success.”

He adds that in 2015 Knoxville will see investment money heading toward stabilized office and industrial buildings.

Although it has a population of less than 200,000, Knoxville boasts three major hospitals, one of which was bought by a hospital system out of Nashville and will be moving to a new location. That’s a deal Adams is working, representing the hospital, which is in the process of acquiring 100 acres west of downtown, in the “hot” part of the city. The only thing holding up the deal is the state signing off on the certificate of need, which should happen by the fourth quarter.

“This move has spurred a lot of spec medical development as a number of doctor offices are jockeying to create space near where the new hospital will be,” Adams says.

## FROM COAST TO COAST

Life is a bit different in many of the major coastal cities across the United States, where investment dollars traditionally flow like a new cabernet poured for a celebration. In the bigger cities where population growth continues, all commercial real estate sectors seem to be afire and investment dollars are coming in from all parts of the globe.

*Professional Report* checked in with SIOR professionals in two coastal mega-metros, Miami and Los Angeles, to see how the economic tides are turning.

“Business is booming,” exclaims **Danny Zelonker, SIOR, CCIM**, broker-partner at Real Miami Commercial Real Estate in Miami, Fla. “In 2014, Miami boomed even more so. Right now we have under permit over 35,000 condos; the city is doing a \$3 billion revitalization of the port and the city’s 228 million square feet of industrial space is at 4 percent vacancy. I sold five industrial properties in the prior 120 days.”

“I expect to see that roll continue,” Zelonker adds. “The key is finding properties. A lot of investors are buying old warehouses and creating new warehouse space. A Chicago real estate investment trust just bought an old Winn-Dixie warehouse to create new product.”

That doesn’t even count hotels, which everyone wants no matter the size. “My partner sold a 29-room hotel for \$11 million,” Zelonker notes.

When asked where all the investment dollars are coming from, Zelonker reports a good portion of it is coming from overseas.

“We have clients from places like Venezuela, Argentina, Chile, and Peru calling all the time.”

Since Miami is a key gateway to South America, foreign capital sources from those countries are not unusual. Adding to that list is European capital. “I’ve done three deals with French nationals,” Zelonker adds. “The tax rate is very high in France, so they are going elsewhere in the world. Miami is one of those places.”

Los Angeles has lagged behind other big U.S. cities in its recovery, but it is catching up very quickly. Like Miami, the town is being flooded with overseas investment capital.

“We see a lot of international capital come into Southern California,” observes **Jonathan Larsen, SIOR**, regional managing principal for Cassidy Turley Commercial Real Estate Services in Los Angeles. “The amount of investment coming from China is incredible, but it’s not just the Chinese, I’m seeing investment capital from Europe, Canada, and Mexico.”

Where is all the capital going? Industrial for a start.

“The Los Angeles basin is the largest industrial market in the country so there is a heavy investment in this category,” says Larsen. “That would include the Inland Empire, where the cost to develop is low, but also the interior of Los Angeles, where the cost of development is high. In Los Angeles, there are a lot of industrial buildings built in the 1970s’ and 1980s’ and they are being torn down and rebuilt to be more efficient. There’s a lot of infill redevelopment.”

Besides industrial, there have been office investments from West Los Angeles to Pasadena, from Orange County to downtown Los Angeles. The latter has been the real surprise.

“The millennials who espouse the live-work-play ethos of a downtown have transformed other American cities and are now causing a renaissance in downtown Los Angeles,” notes Larsen. “We have 50,000 people living in downtown, whereas we used to have just a couple of thousand. Another 50,000 residential units are being built.”

Development has also begun on the Wilshire Grand Center in downtown Los Angeles, which will be the tallest building in the United States west of the Mississippi River. Wilshire Grand will be home to 400,000 square feet of office space and a hotel.

In addition to all that, in an area east of downtown Los Angeles, an old Ford plant and Coca-Cola bottling facility are being renovated for tech clients.

“Other hot sections of the metro include Santa Monica/Playa Vista, where, in the past 18 months, over 450 tech start-ups have nested,” says Larsen. “A lot of private equity capital is coming in to fund these start-ups.”

Considering all this, Larsen summed up his thoughts for the near future in Los Angeles: “Expect a boom in 2015.” ■