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# *Survey of Emerging Market Conditions*

**Quarter 3 2008**

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For more information about the survey or the Bergstrom Center for Real Estate Studies, visit our website at [www.realestate.ufl.edu](http://www.realestate.ufl.edu).

## Executive Summary & Conclusions

Last quarter we cast our respondents' diagnosis of Florida real estate markets in medical terms. To continue that perspective, there has been little healing. Many condominium markets remain very sick, with the likelihood of fatal outcomes for many projects. Single family development, however, shows a hint of stability. Even so, this may have little immediate impact because the housing industry is so diminished at this time. Among rental property markets, the malaise continues to be seen as generally temporary in the sense that some near-term indicators are weak, but longer term indicators are more neutral. A remarkable finding is that, despite reporting their views in the midst of major financial failures – Washington Mutual, AIG and Lehman Brothers – our respondents continue to express a mainly positive investment outlook.

### *Highlights*

- Despite the financial crisis and the dismal news of Florida's ownership housing markets, our respondents continue to see a more neutral picture for apartment, commercial and industrial markets in the state.
- The general investment outlook for Florida real estate is edging more positive, though still mixed.
- The outlook for single family residential development has a glimmer of hope. Absorption rates are seen as steady rather than declining, price changes are seen as slightly less weak, and the investment outlook is mixed to positive, and improved.
- Market rate apartments and industrial are viewed as more stable this quarter (steadier occupancy and rental rate outlook) and with a mixed but improving investment outlook.
- Office markets continued a decline for the short run. However, though occupancy expectations became slightly more negative and the rental rate outlook remained weak, the investment outlook held at mixed to positive.
- The weakest rental markets are seen to be in retail. All retail except free standing saw weakened occupancy and rental rate outlook, though the investment outlook remained mixed.
- Cap rates finally trended upward, probably indicating increased long term uncertainty. Cap rates for market rate apartments increased significantly, from 6.6 percent to 7.5 percent.
- The respondents' perception of their own business outlook, which has declined steadily for eleven quarters, took an even larger turn downward this quarter.
- Respondents are now reporting a downturn in the availability of capital, consistent with the general financial crisis.

### *The Survey*

Our quarterly survey, conducted by the Bergstrom Center for Real Estate Studies, Warrington College of Business Administration, University of Florida is in its twelfth fielding. The total number of participants, at 392, is the most extensive survey of Florida professional real estate analysts and investors conducted on an ongoing basis. It includes respondents representing thirteen urban regions of the state and up to fifteen property types.

### **General Investment Outlook**

Our general index of real estate investment outlook, weighted 40 percent for single family and condo development, 40 percent for apartments and commercial rental property and 20 percent for developable land, shows remarkable continuing stability and resilience in contrast to the gloomy media picture of Florida real estate. In the midst of such financial shocks as the failure of Washington Mutual, Lehman Brothers and AIG, our respondents actually raised slightly their assessment of the investment outlook for Florida real estate.

### **Single Family & Condominium Development**

While absorption of new single family residences is low, the encouraging news is that our respondents see it as stable. This cannot be said for condo absorption, where respondents expect further decline. The expectation for price changes remains quite pessimistic for both types of residential development, though the assessments improved slightly for the second quarter in a row. Despite expected flat to declining prices, the outlook for investment in single family development improved, edging across neutral into positive.

### **Apartments**

Expectations for apartment occupancy rebounded from a dip last quarter. For market rate apartments, views climbed back to an expectation of rising occupancy, though the same can't be said for condo conversions. However, the rising occupancy still is expected to be offset by weak rental rates, increasing slower than inflation. Despite this, our respondents see the outlook for investment in market rent apartments as significantly positive, and improved.

### **Industrial**

The outlook for industrial occupancy recovered significantly from a sharp drop last quarter. While still cautious, the balance of opinion appears to be for no change rather than for decline. This applies to both Warehouse and Distribution, and Flex Space, R and D Office-warehouse. Consistent with the caution, rental rates are expected to lag inflation. However, the outlook for investment continued to improve for both categories of industrial, reaching into the positive side of mixed.

### **Office**

Expectations for office occupancy continue to inch downward, reaching a consensus for declining occupancy. Consistent with this view, the expectation is for rental rates to continue lagging inflation, as with last quarter. Nevertheless, despite the turmoil in financial markets and concerns about occupancy and rental rates, respondents still maintain a slightly favorable outlook for investment in offices, both Class A and Class B.

### **Retail**

Retail has, by a small margin, the least favorable outlook. The occupancy outlook for four types of retail continues to lean toward declines, and rental rates are clearly expected to lag inflation. The one type of retail that is viewed slightly more positively is Free Standing, but not enough to reverse the overall picture. Once again, despite the weak occupancy and rental rate expectations, the outlook for retail investment is mixed to positive.

### **Land Investment**

While respondents saw the outlook for investment in land as remaining cautious to mixed, their view was slightly improved for all types of land. The improvement was most notable for land with warehouse/R&D entitlements.

***Capital Availability***

The financial shocks of recent weeks were clearly felt by our respondents. Their assessment of capital availability took a sharp turn downward. While the expectation for availability of capital for acquisitions still remains mixed, the expectation is for availability of development capital to decline.

***Cap Rates & Yields***

Cap rates are reported to have finally drifted upward after nearly two years of little change. Industrial cap rates pushed upward some 50 basis points (0.5%) to near eight percent, while office and retail cap rates increased about 25 basis points (0.25%) to the mid and upper seven percent range. Apartments were the extreme in change. Cap rates for market rent apartments already had drifted upward since the first quarter of 2006 by nearly 100 basis points (1.0%). They jumped again in the last quarter for an overall change of more than 150 basis points, to 7.5 percent.

***Own Business Outlook***

The generally positive tone in the investment outlook of our respondents does not carry to their own business. Own business outlook continued a very steady three-year decline, and at one of the sharpest rates of descent yet.

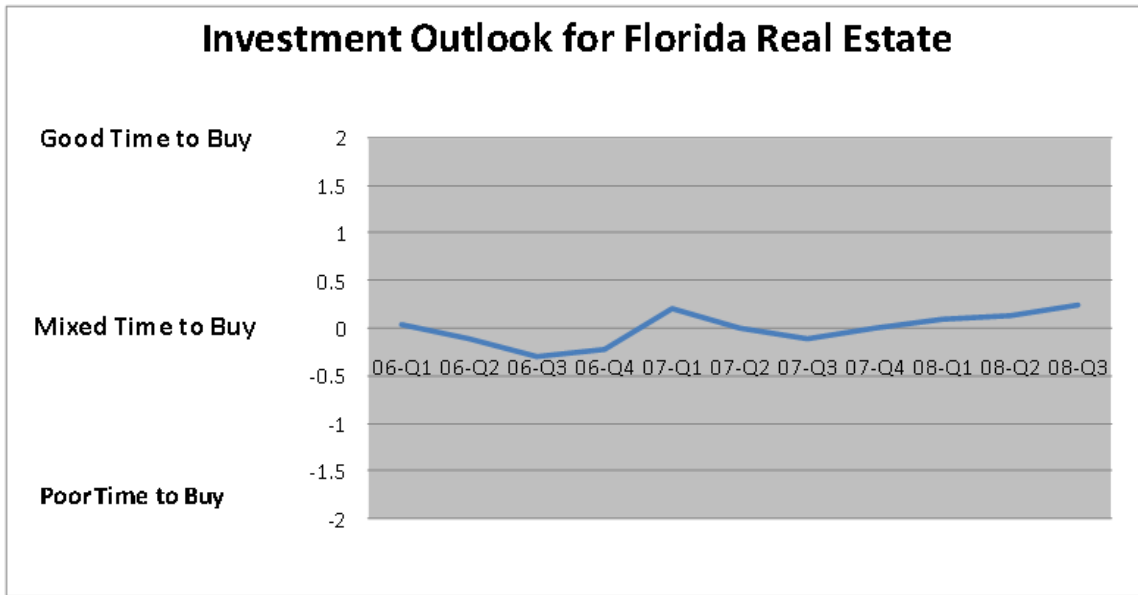
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## Section 1: Overall Investment Outlook

Despite severe concerns about the state of real estate finance and growing caution over rental markets, the overall investment outlook for Florida real estate remained remarkably buoyant. Even in the midst of the financial shocks of Washington Mutual, AIG and Lehman Brothers, our respondents actually improved slightly their view of investment in Florida real estate.

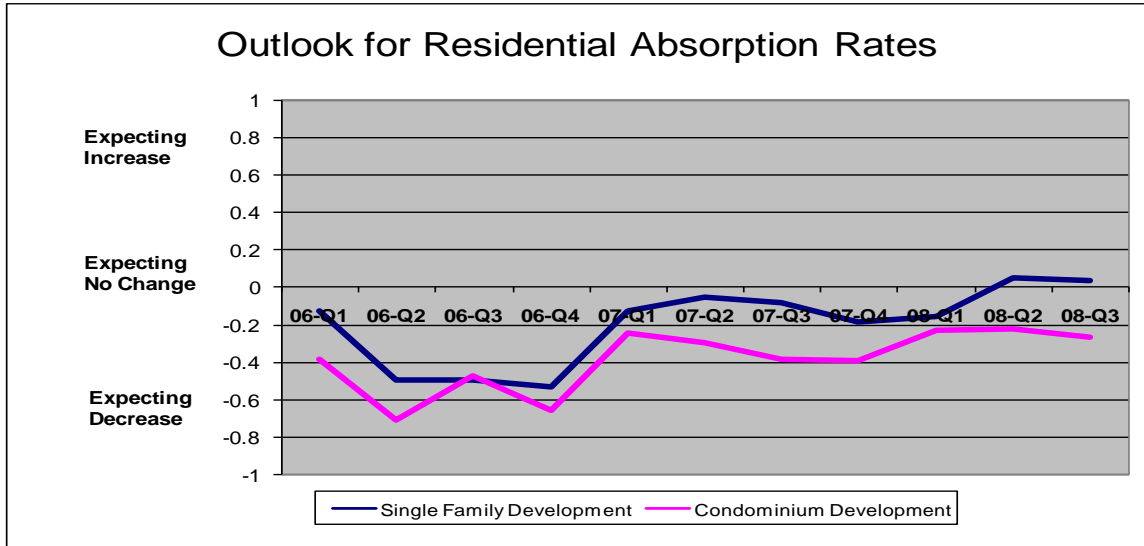


This investment index is weighted 40 percent on single family and residential condominium development, 40 percent on rental property of all types, and 20 percent on undeveloped land. Thus, it is at least fifty percent driven by the residential development outlook.

## Section 2: Residential Development

### *Expected Absorption Rates*

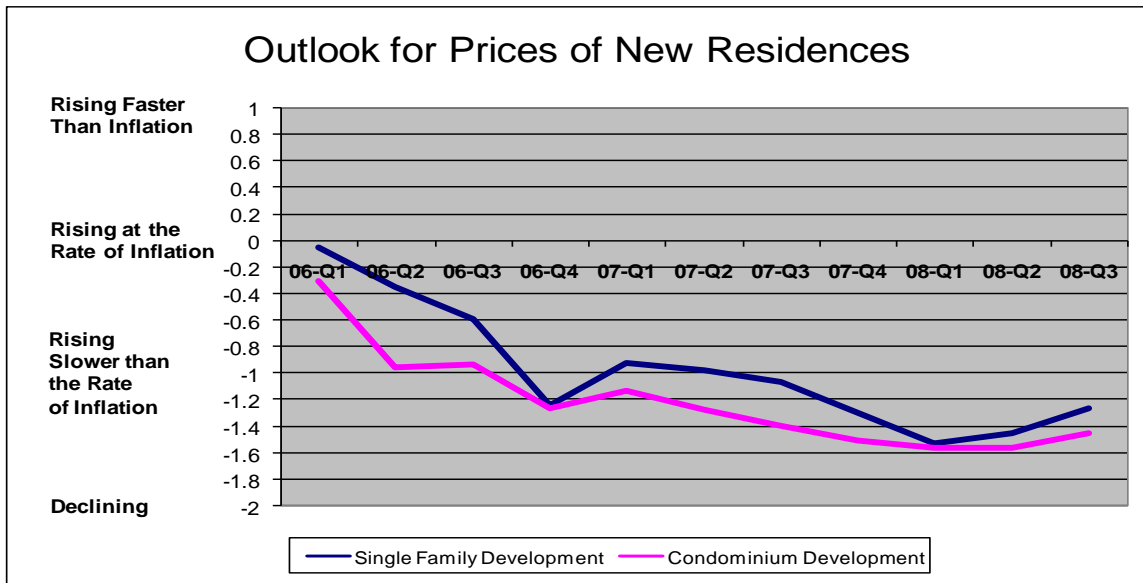
The outlook for absorption rates in single family development has remained relatively stable for the past six quarters. Respondents continue to expect no change in the immediate future. As has been the case over the past two years, expectations for absorption rates in condominium development remain more pessimistic than those in single family.



### *Expected Price Changes*

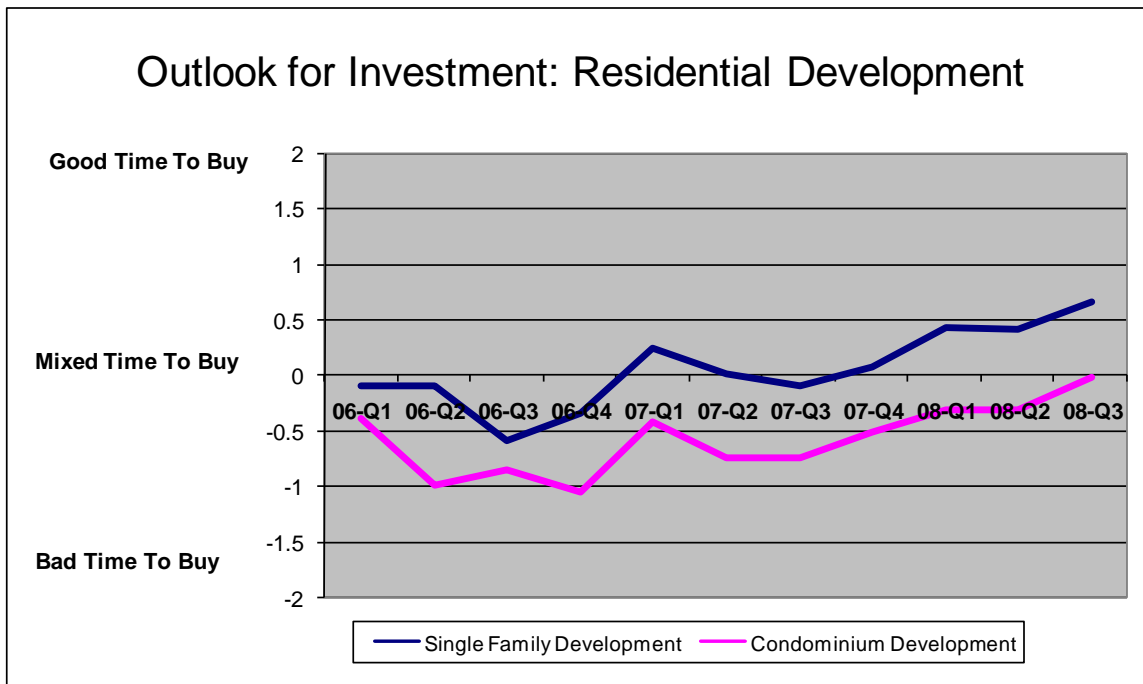
In the previous quarter, expectations for single family development began to indicate that a less pessimistic outlook may be on the horizon. This quarter, it appears that our respondents may believe that prices for new Florida residences are beginning to inch their way back. Nonetheless, price increases of new residences are still expected to lag inflation in the immediate future.





**Investment Outlook**

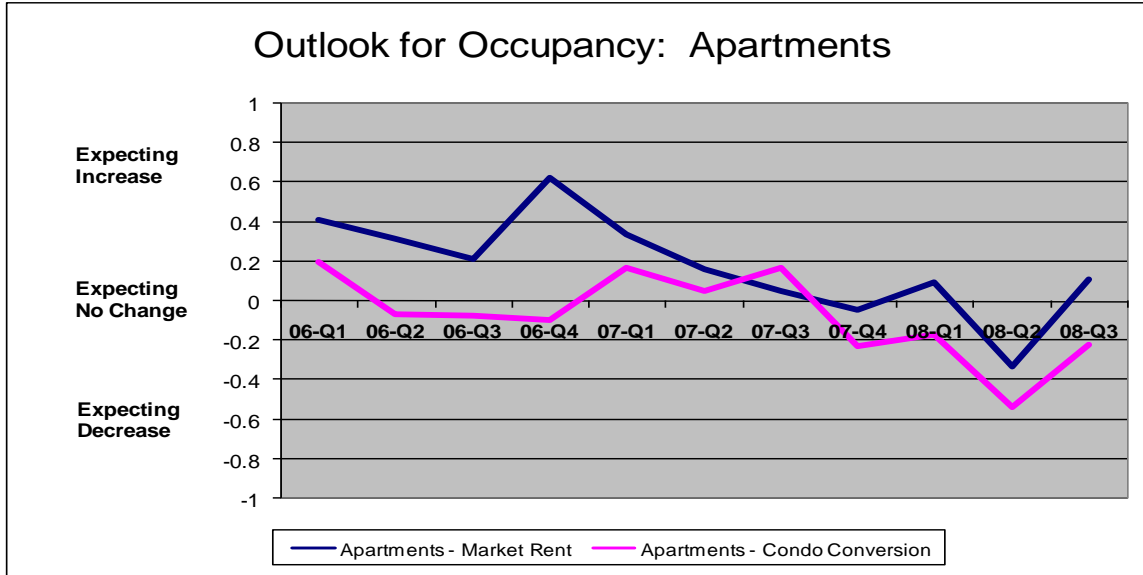
The outlook for investment in single family development has become increasingly optimistic over the past four quarters. Many of our respondents believe that it may soon be a good time to buy in single family development, whereas the outlook for condominium development continues to be mixed.



### Section 3: Apartments

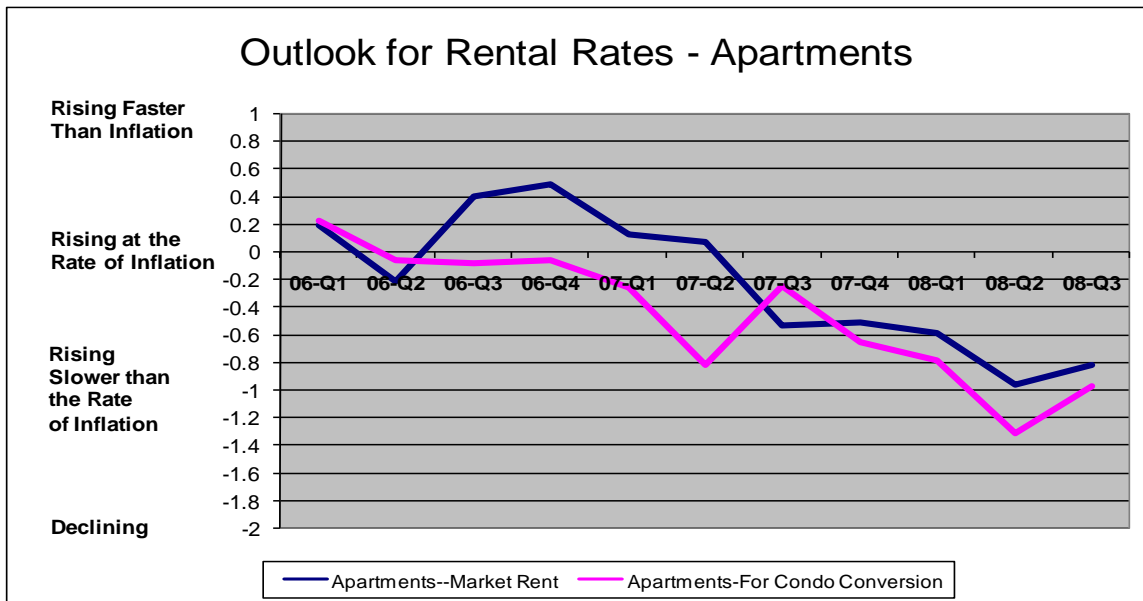
#### Expected Occupancy

Despite indications last quarter that occupancy rates may decrease in the near future, respondents appear to have scaled back their pessimism. Occupancy rates for both market rent and condo conversion apartments are expected to remain unchanged over the next quarter.



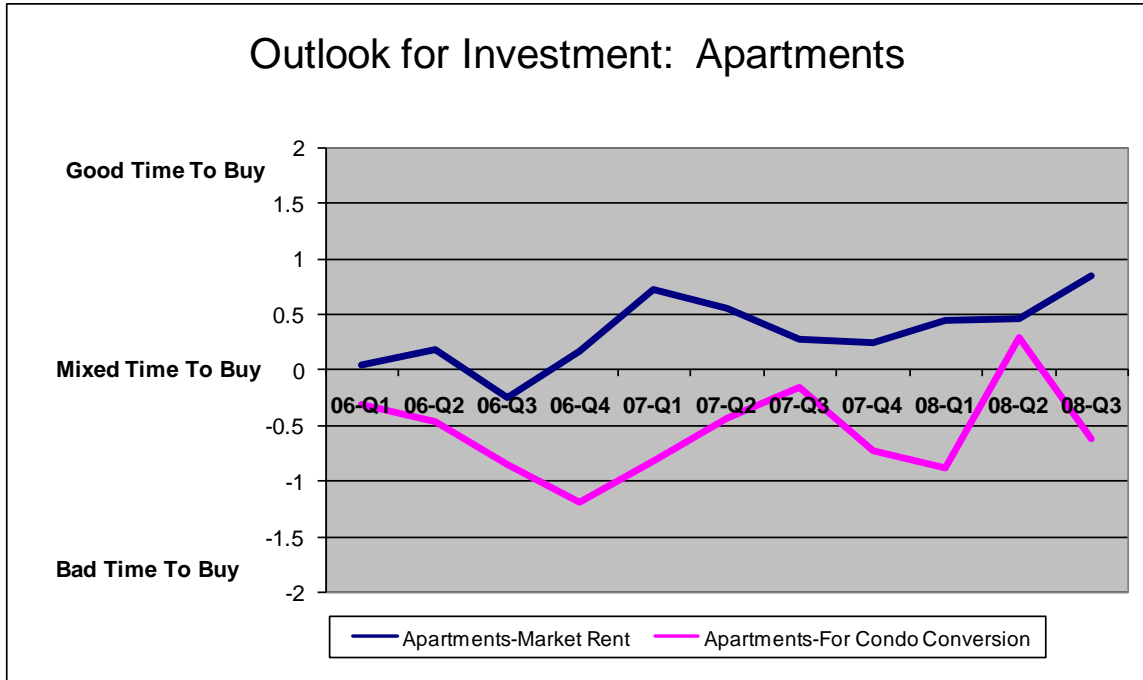
#### Expected Rental Rates

The outlook for apartment rental rates still remains pessimistic as our respondents expect rates for both market rent and condo conversion apartments to rise at a rate slower than inflation. Despite indications this quarter that rental rate increases may soon begin to approach the rate of inflation, the timing of this change remains quite uncertain.



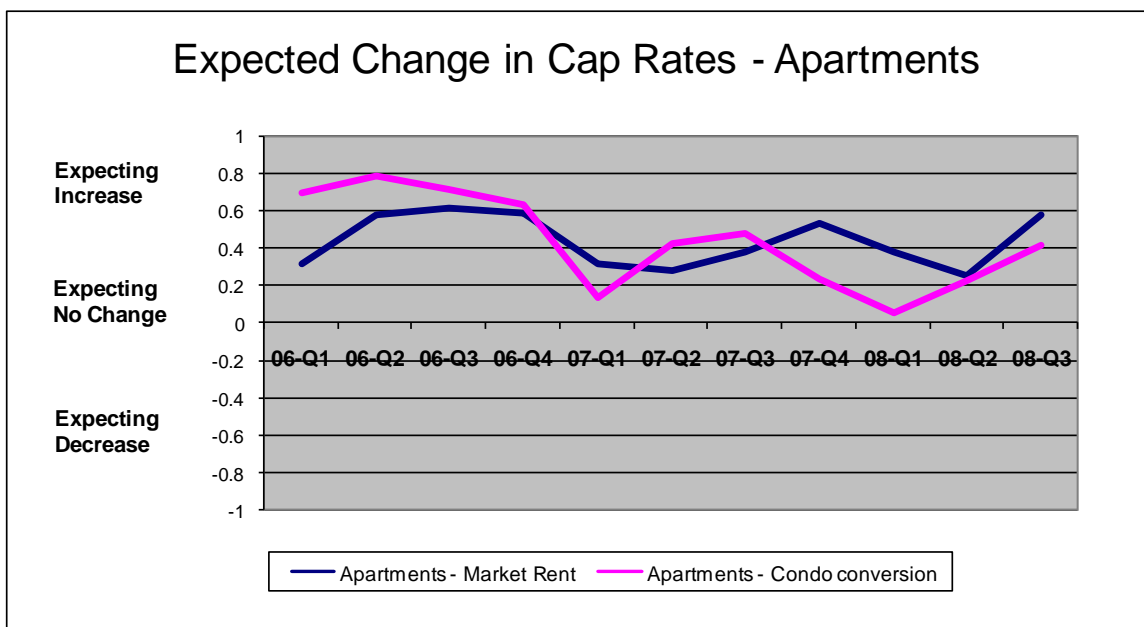
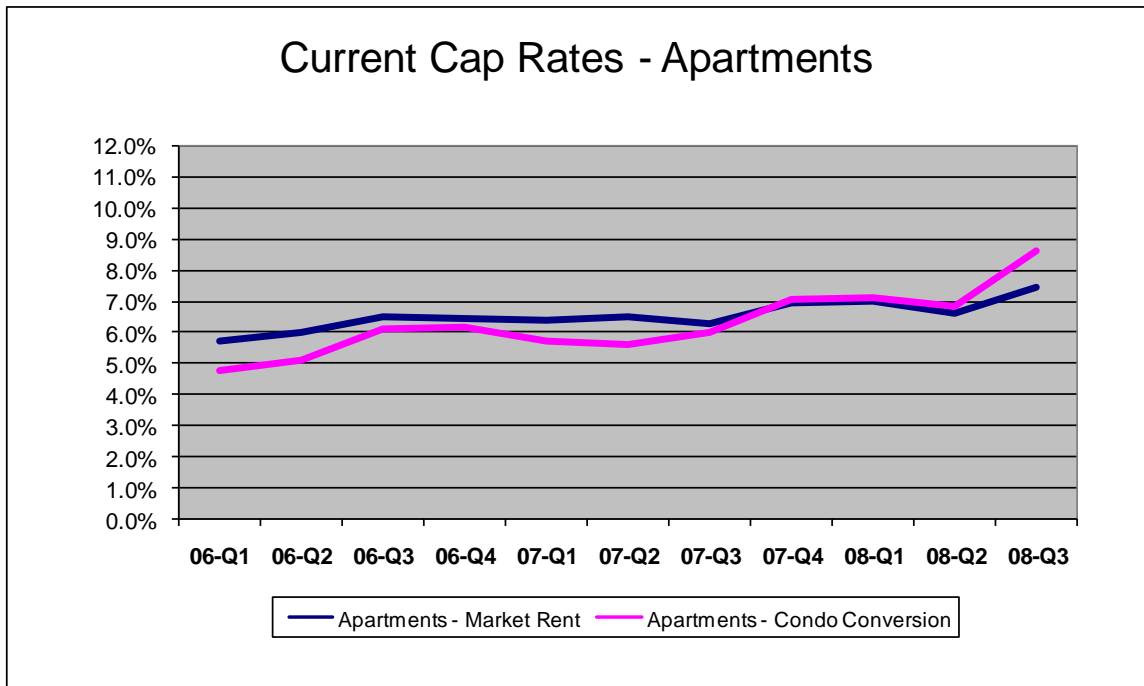
**Investment Outlook**

The investment outlook for condo conversion apartments has weakened significantly this quarter as respondents indicate that it may still be a bad time to buy. Conversely, the investment outlook for market rent apartments continues to increase as respondents now indicate it may be a good time to buy within this sector.



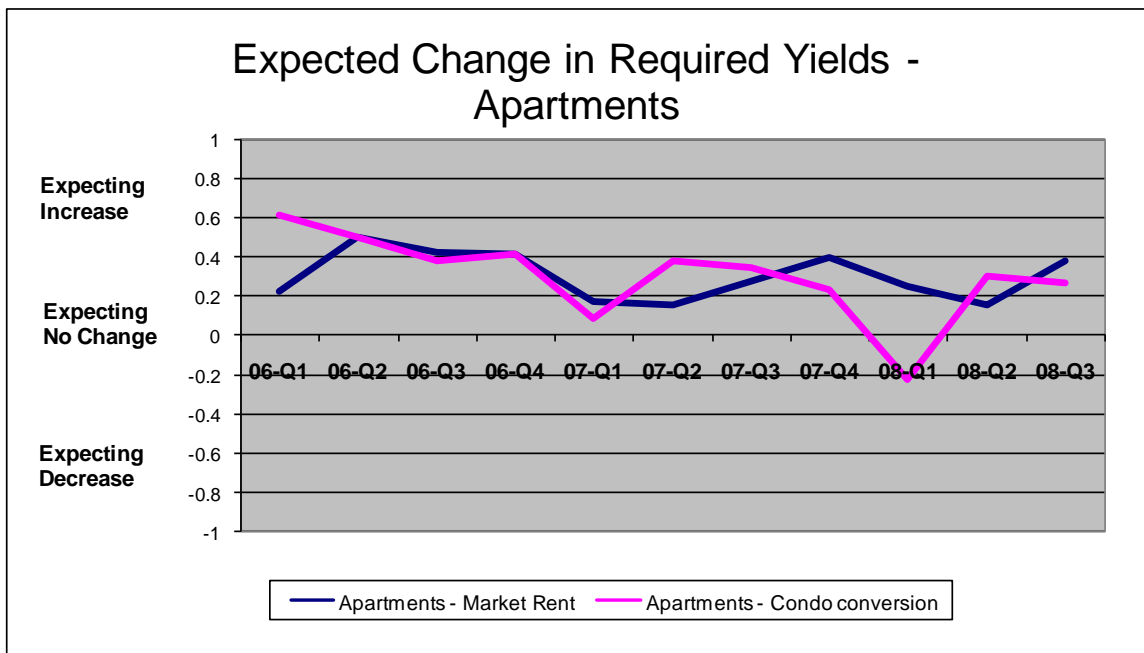
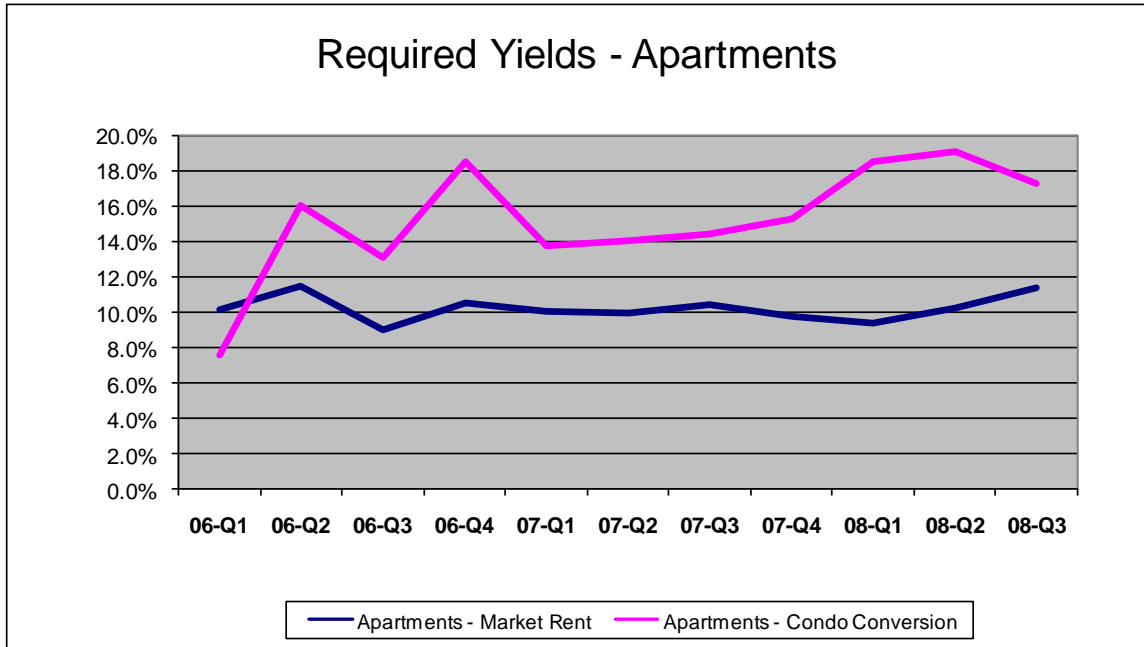
**Cap Rates**

Cap rates are a significant indicator of fundamental condition in real estate markets. The fact that apartment cap rates in Florida have remained at a relatively low level, with virtually no movement over the previous two quarters, signals that investors have remained steady in their confidence and risk perceptions of apartments during that time. However, in the most recent quarter, the average cap rate for condo conversion apartments has increased significantly from 7% to 8.5%. It appears that respondents also expect this increase to continue into the future. Cap rates for market rent apartments have experienced a much more modest increase, up roughly 0.5%. Respondents expect rate increases on these properties to continue as well.



**Required Yields**

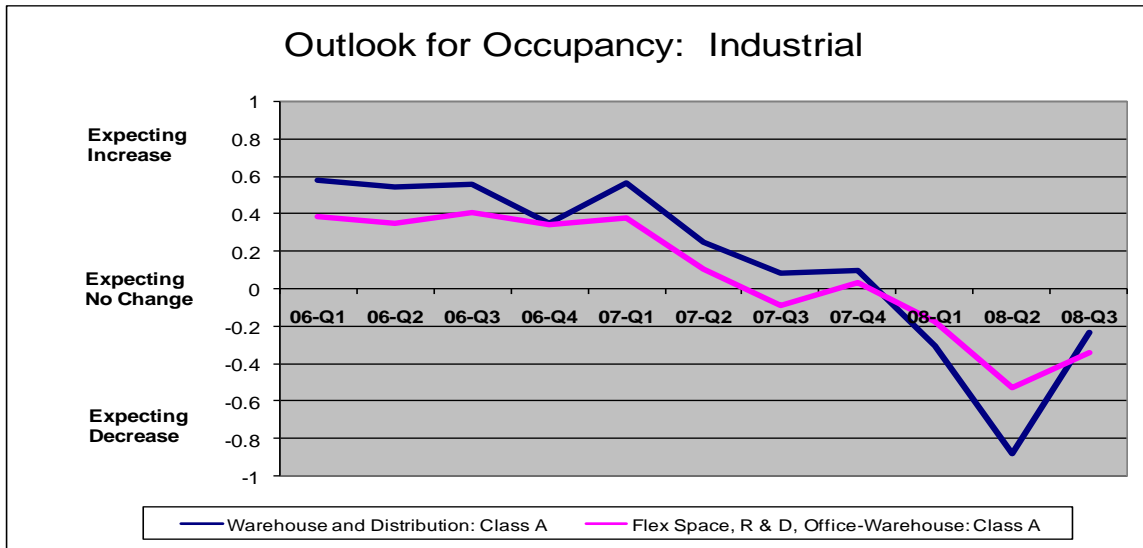
Despite last quarter's expectations of an increase in required yields for condo conversion apartments, rates actually declined in the third quarter. Respondents appear to have scaled back their expectations for future rate increases in favor of a more neutral outlook. Required yields for market rate apartments, on the other hand, have increased since last quarter, and respondents expect this upward trend to continue.



## Section 4: Industrial

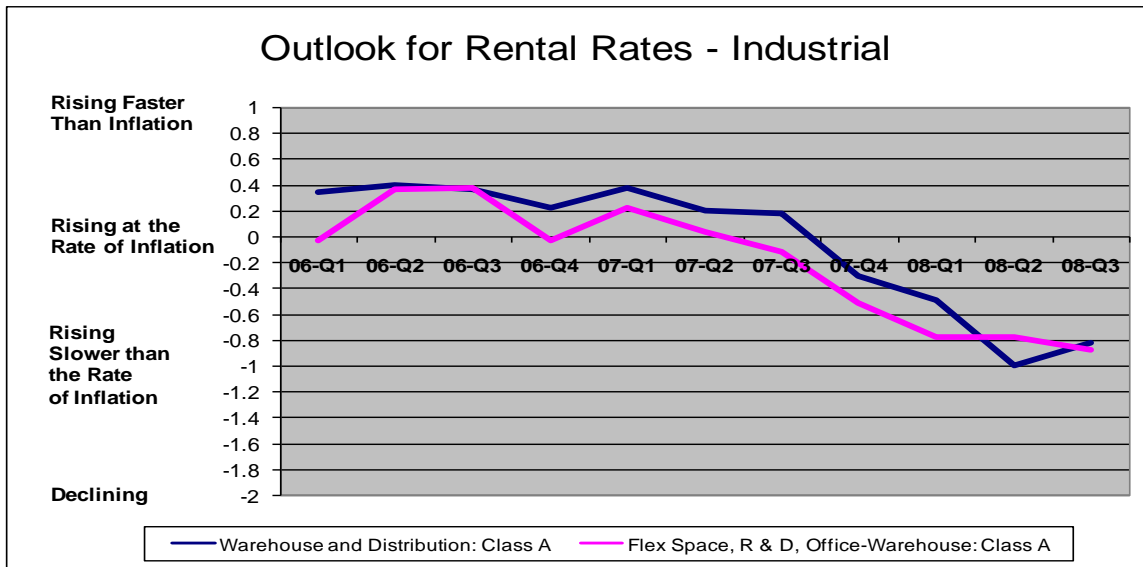
### Expected Occupancy

There has been a dramatic shift in the outlook for occupancy rates in warehouse and distribution over the past quarter. In contrast to last quarter's expectations of rate decreases, our respondents now expect no change in occupancy rates. The occupancy outlook for flex space has also improved from last quarter, although much more modestly. It appears that respondents expect rates to stay fairly steady in the immediate future.



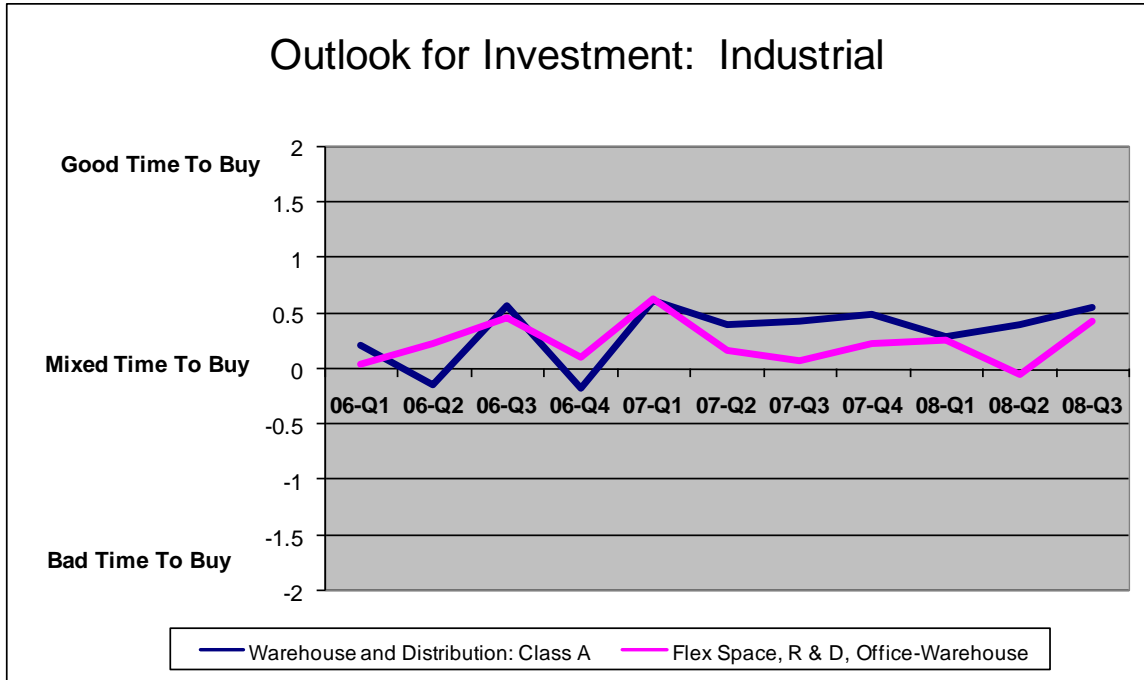
### Expected Rental Rates

While there may be slight indication that rental rate expectations will improve for warehouse and distribution in the future, respondents still currently believe that rents will rise slower than inflation. The rental rate outlook for flex space remains pessimistic as expectations have continued to weaken over the past quarter.



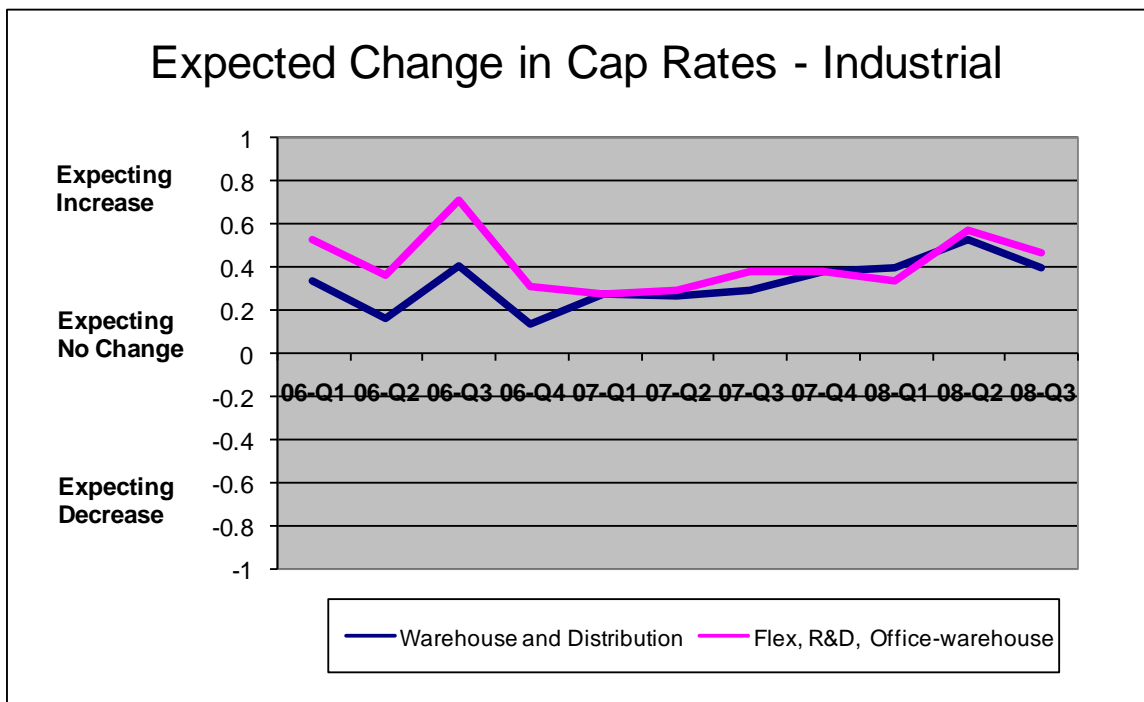
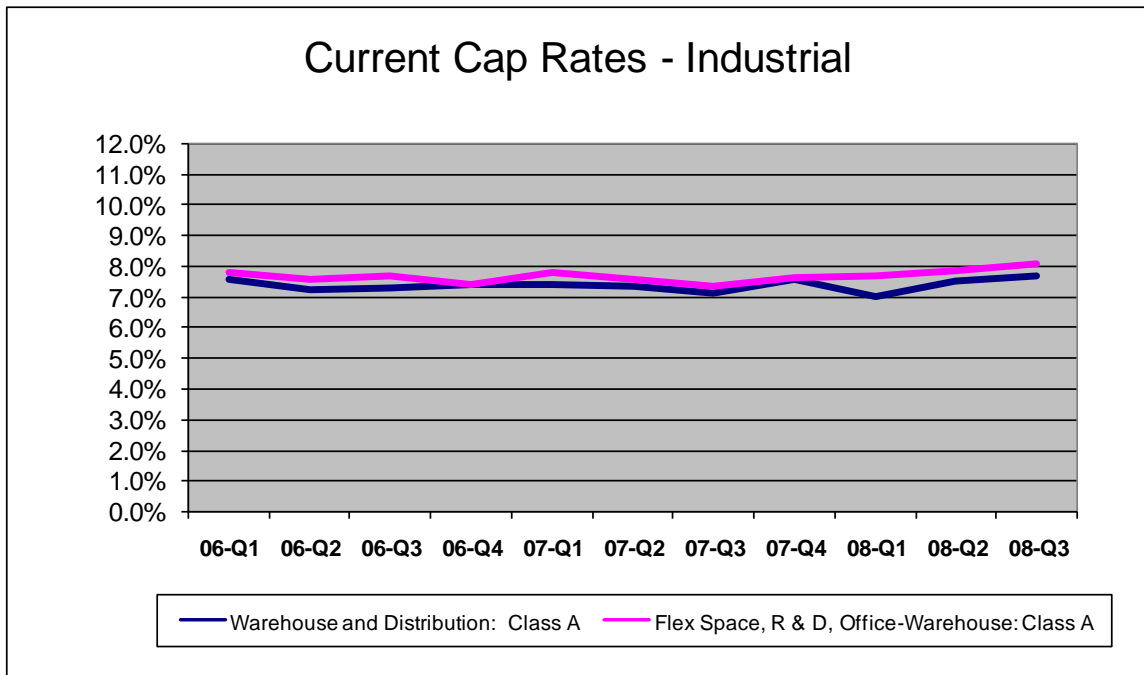
**Investment Outlook**

The investment outlook for warehouse and distribution has improved slightly over the last quarter. Respondents have begun to indicate that it may soon be a good time to buy within this sector. The outlook for flex space has also improved over this period, yielding expectations that closely resemble those of warehouse and distribution.



**Cap Rates**

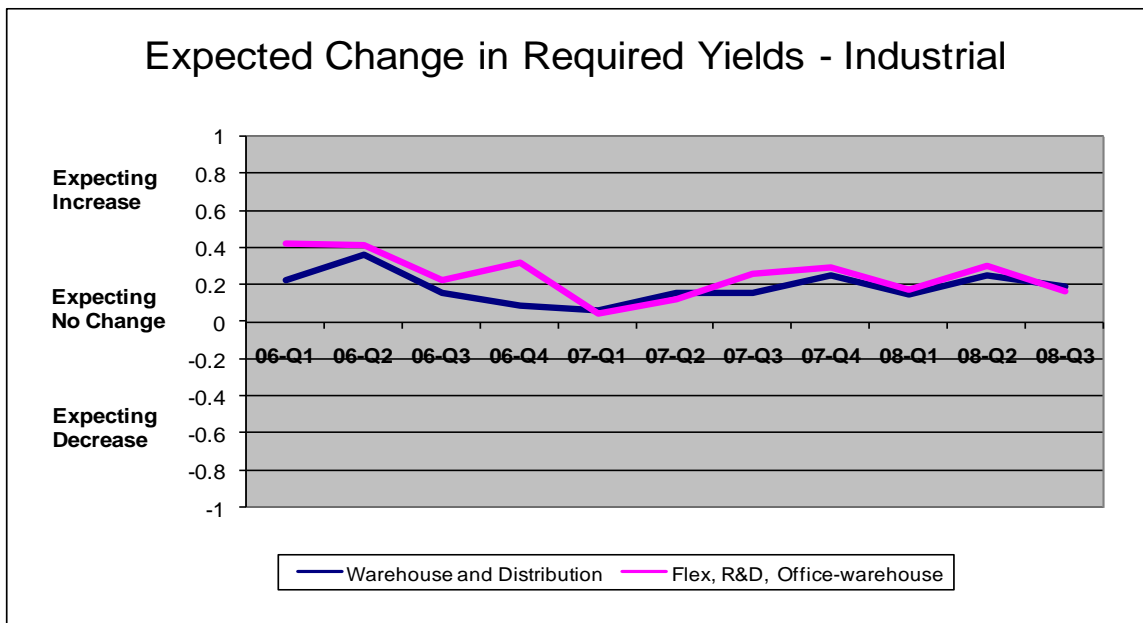
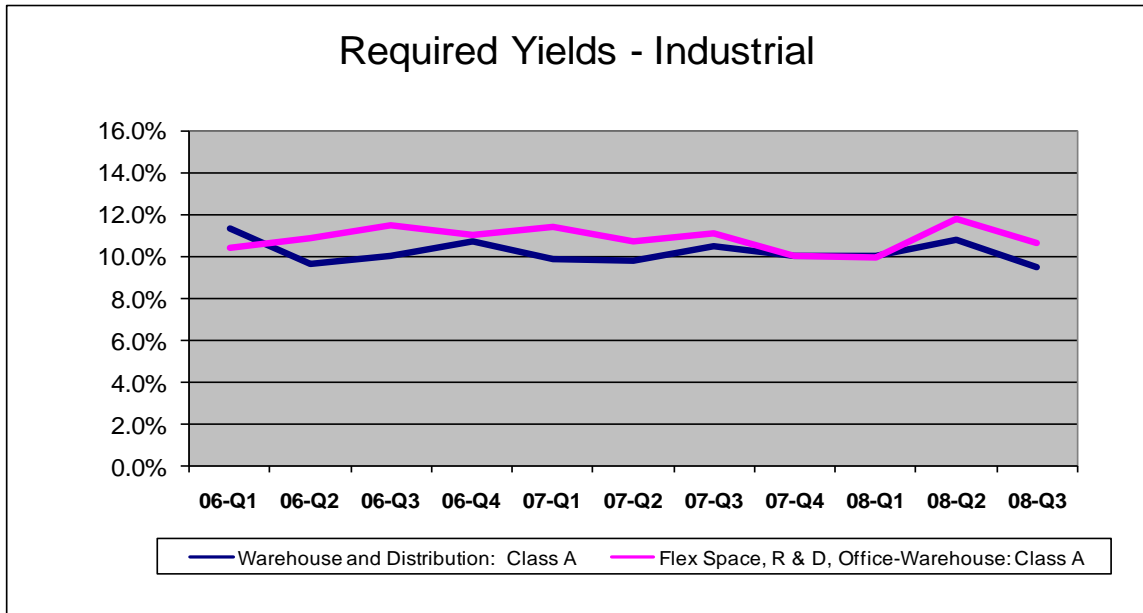
Over the last eleven quarters, actual cap rates for industrial properties have remained relatively stable. However, expectations over the same period have not been as consistent. As has been the case for the past seven quarters, respondents continue to indicate that they expect future cap rates to increase for both warehouse/distribution and flex space. However, respondents appear to have scaled back their expectations from a quarter ago, and may be moving towards a more neutral outlook.





**Yields**

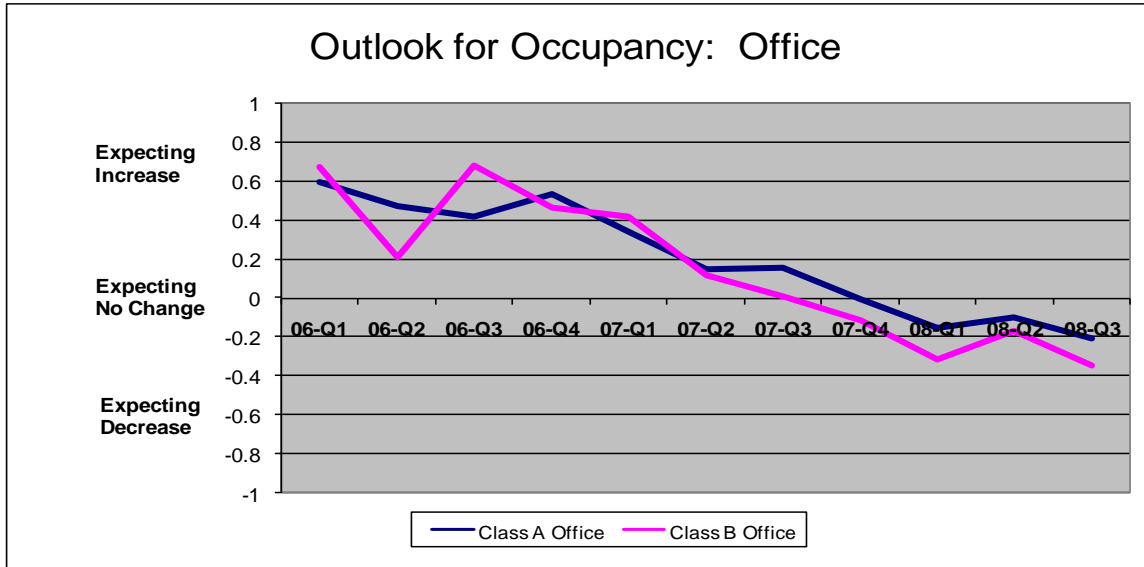
Over the past eleven quarters, required yields have shown slight volatility from quarter to quarter. Most recently, required yields for warehouse and distribution, as well as flex space, have declined. Required yields for flex space remain higher than those for warehouse space. Our respondents believe that yields for both property types will remain stable over the next quarter.



## Section 5: Office

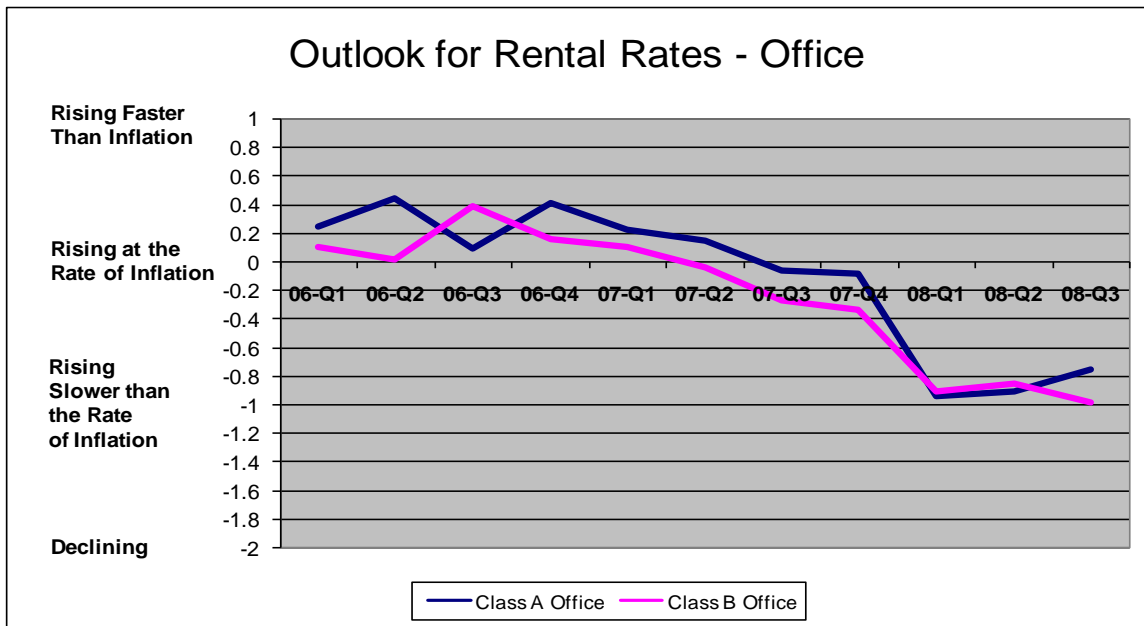
### Expected Occupancy

With the exception of last quarter's glimpse of optimism, the outlook for office occupancy has continued its weakening trend. Overall, there has been a consistent decline in respondent expectations for occupancy in office properties that dates back to 2006.



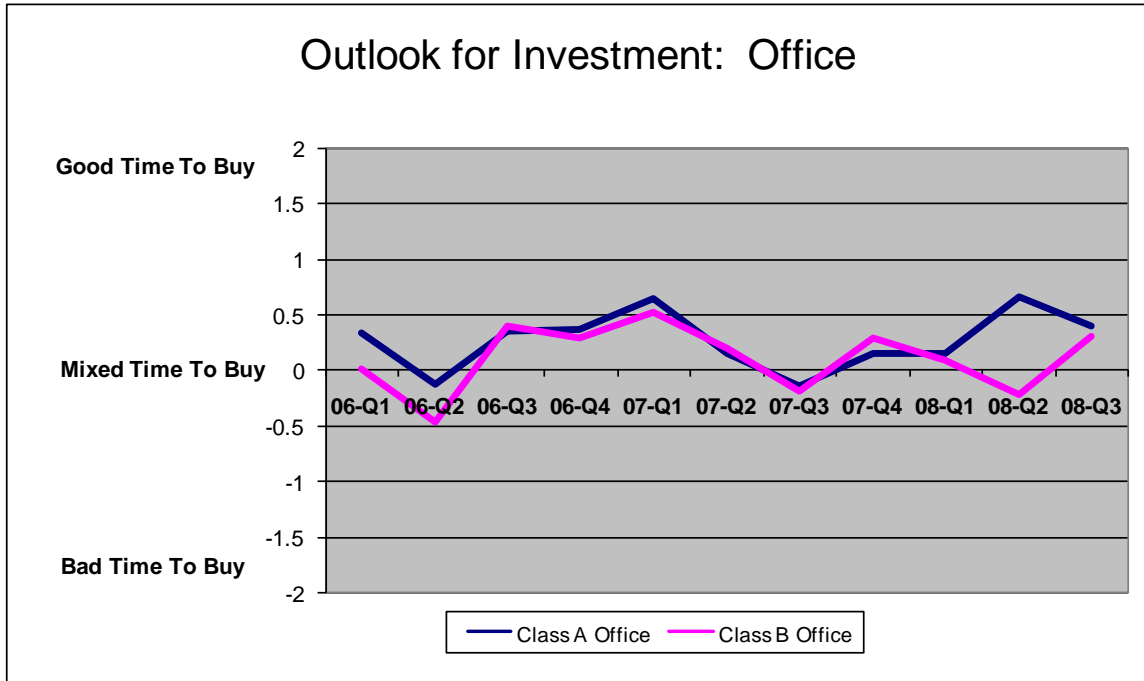
### Expected Rental Rates

Respondents continue to indicate that office rental rates are expected to increase at a rate that is slower than inflation. The outlook for rental rates in Class B office properties is more pessimistic than that of Class A, as expectations for rate increases continue to diminish within this property classification.



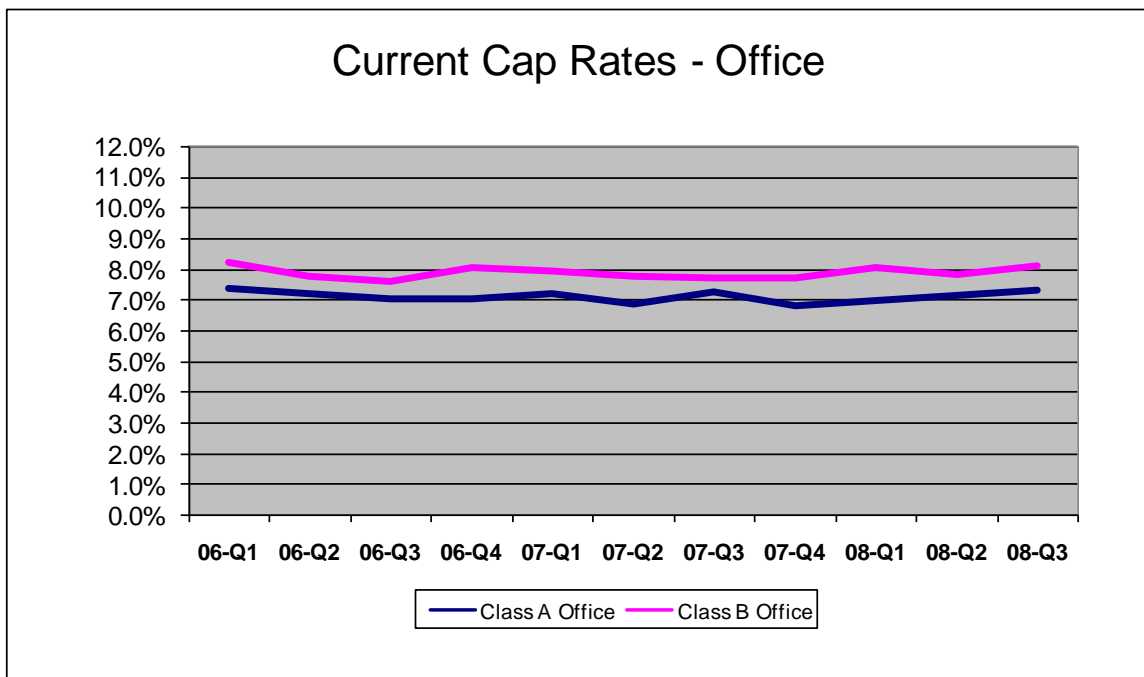
**Investment Outlook**

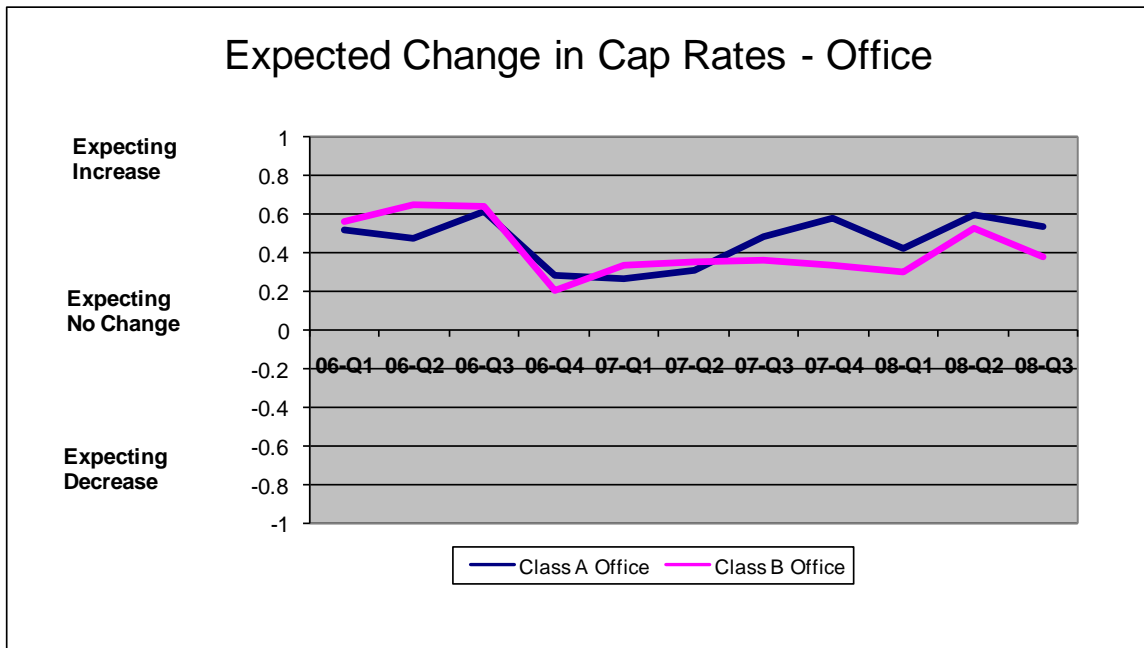
The investment outlooks for Class A and Class B office space appear to have converged over the last quarter. For both property types our respondents believe that it is a mixed time to buy.



**Cap Rates**

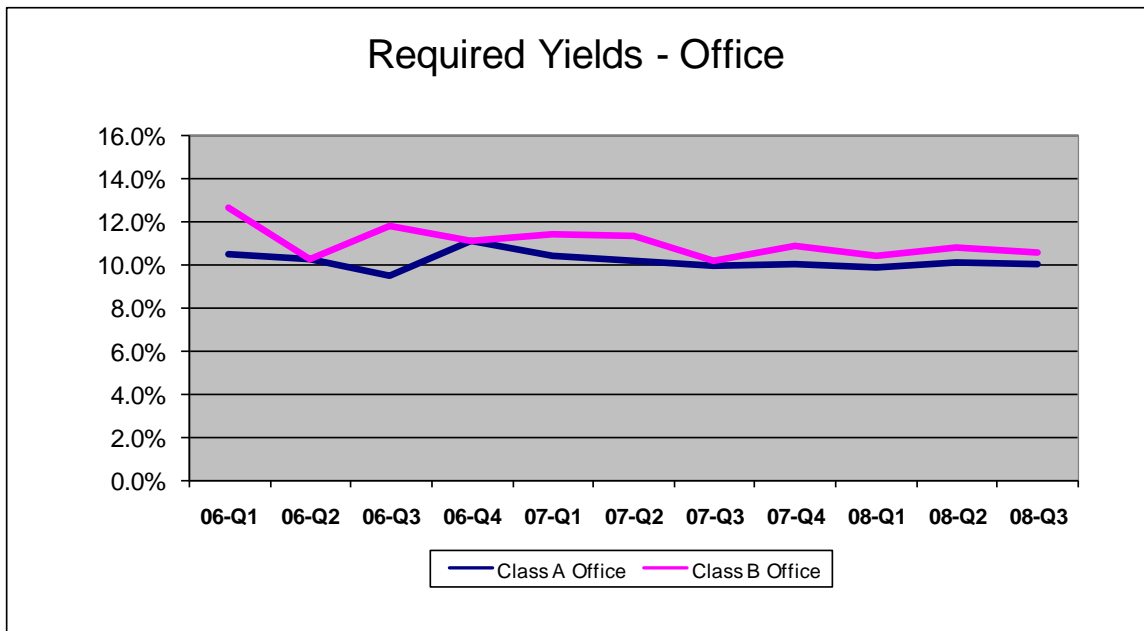
Cap rates for office space have remained virtually unchanged since the first quarter of 2006. Nonetheless, respondents continue to expect future cap rate increases in Class A office. Expectations for rate increases in Class B have been scaled back from last quarter and appear to be headed toward neutrality.

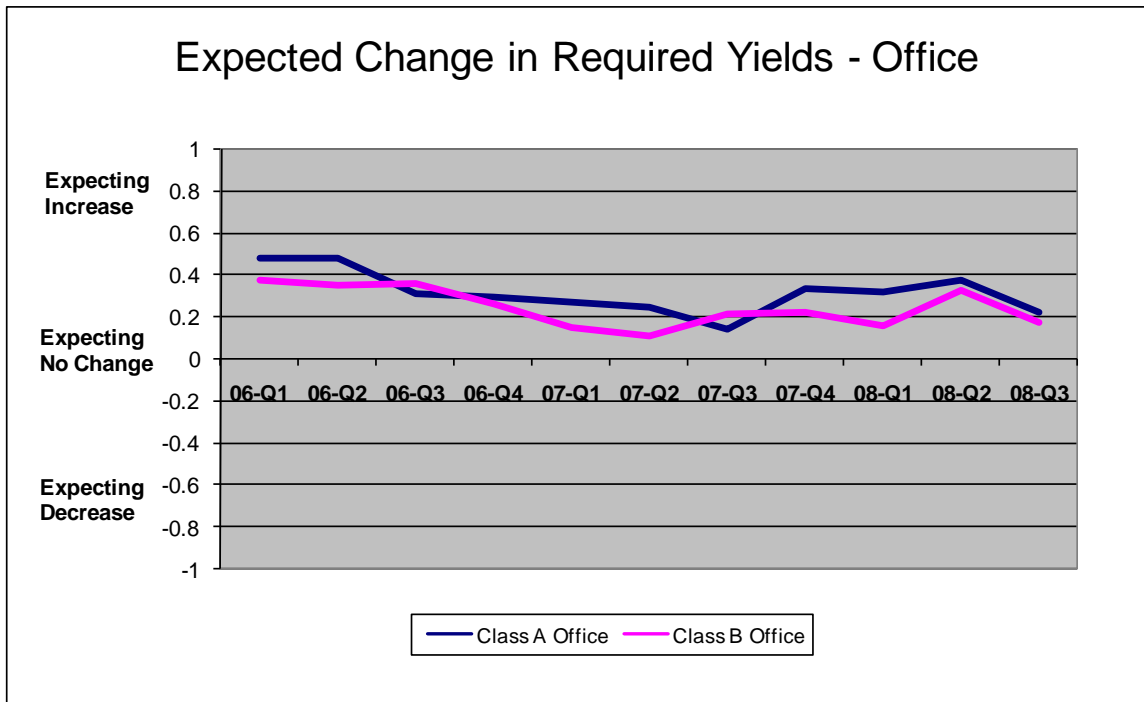




**Yields**

Required yields for office space have remained relatively stable over the past four quarters. Over this period, Class B yields have been slightly higher than those of Class A, reflecting more perceived risk in Class B. Respondents expect yields to remain the same over the next quarter for both classes of office property.

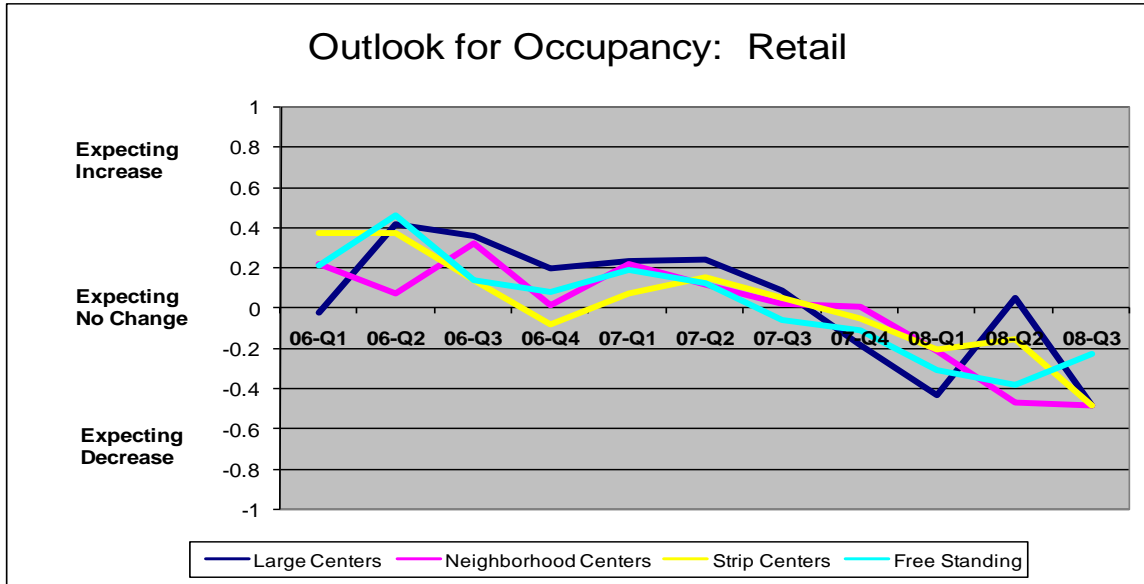




## Section 6: Retail

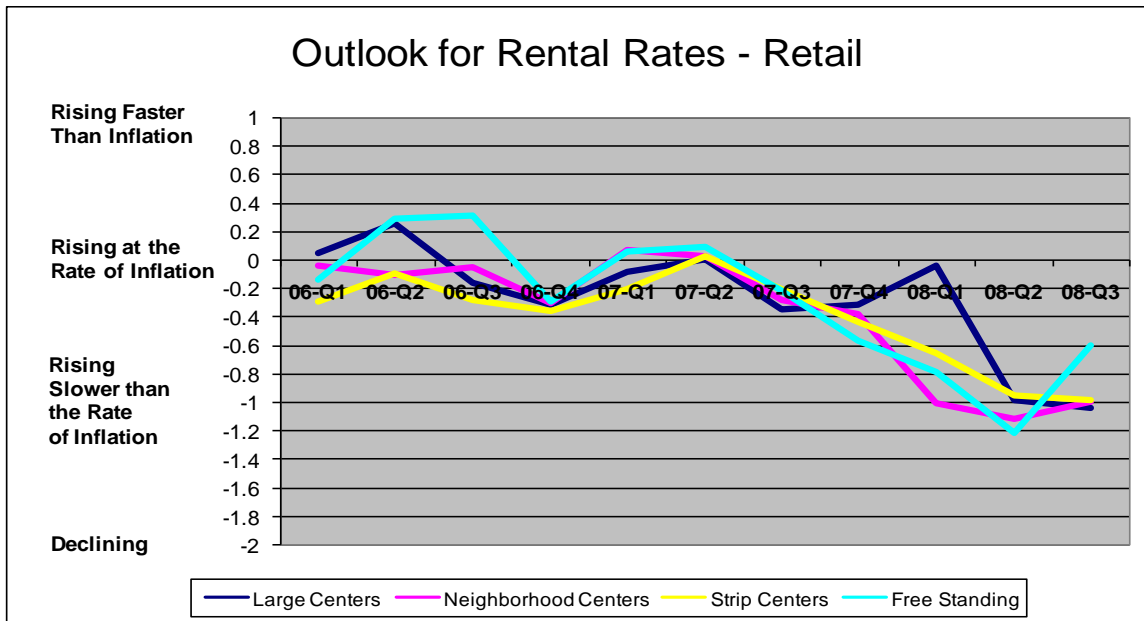
### Expected Occupancy

Over the last four quarters, there has been significant volatility in occupancy rate expectations across retail classifications. With the exception of free standing, respondents expect potential occupancy rate decreases for retail properties in the future.



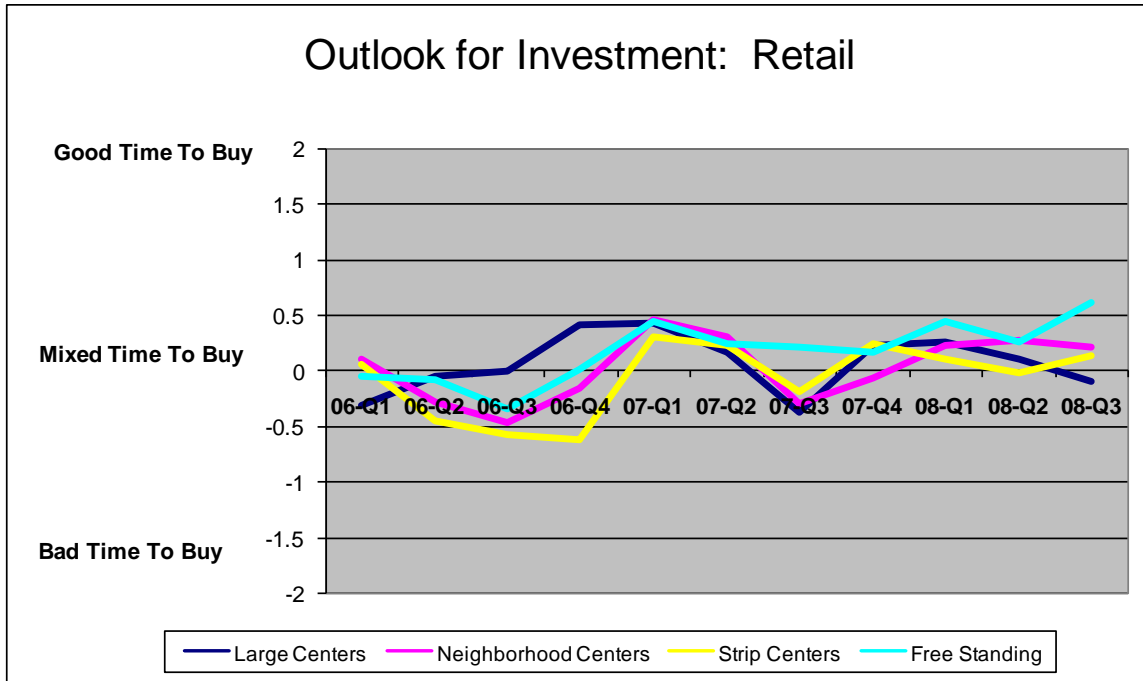
### Expected Rental Rates

For large centers, neighborhood centers, and strip centers, respondents continue to believe that rental rates will rise slower than inflation. The outlook for free standing retail centers, in contrast, is beginning to show more optimism than that of its counterparts as it appears that expectations for rates to increase at the rate of inflation may be on the horizon.



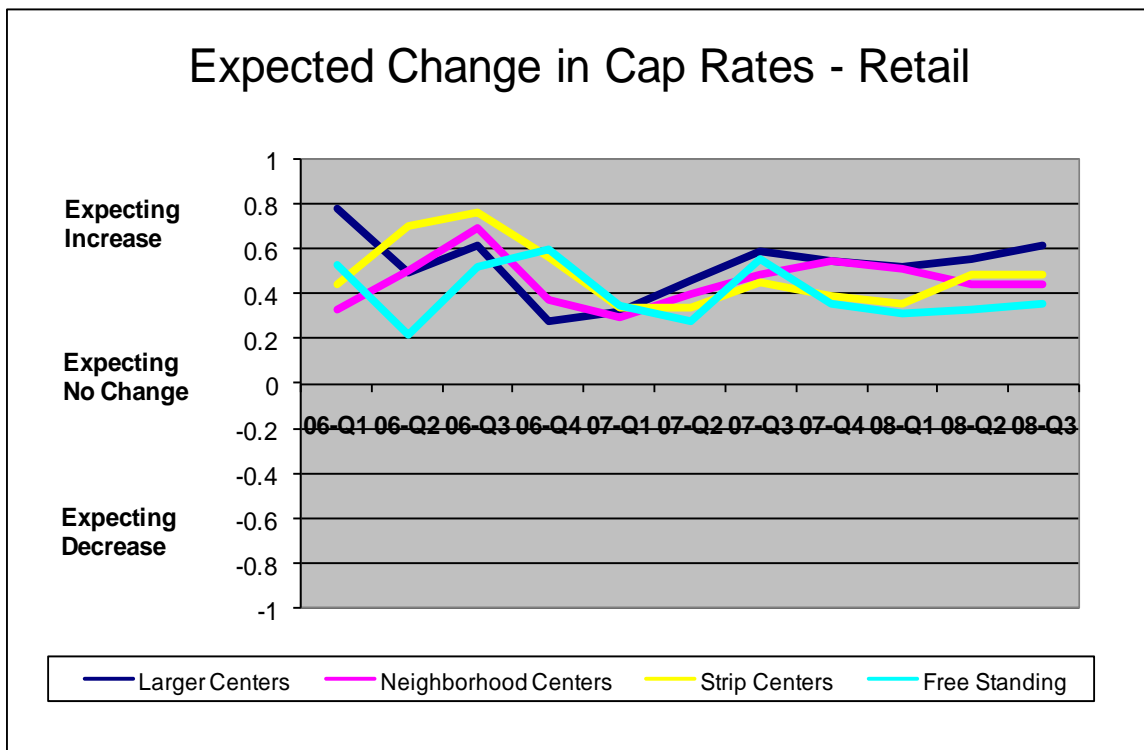
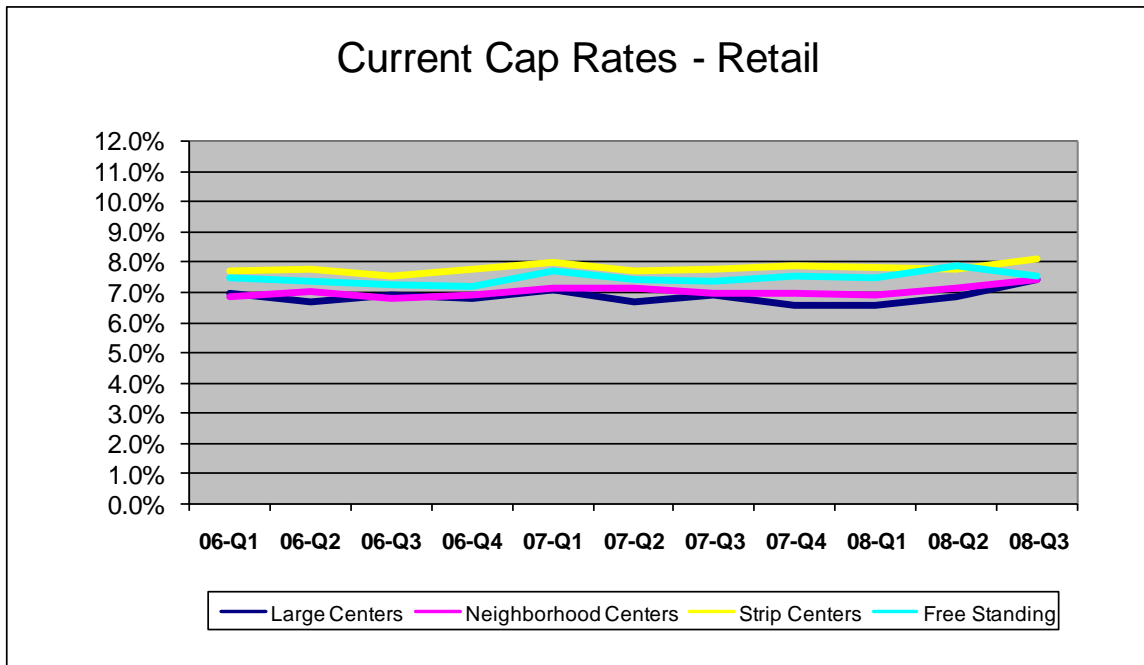
**Investment Outlook**

Respondents believe that it is a mixed time to buy in large retail centers, neighborhood centers and strip centers. Free standing centers, however, continue to defy the trends of its counterparts as our respondents indicate that it may soon be a good time to buy.



**Cap Rates**

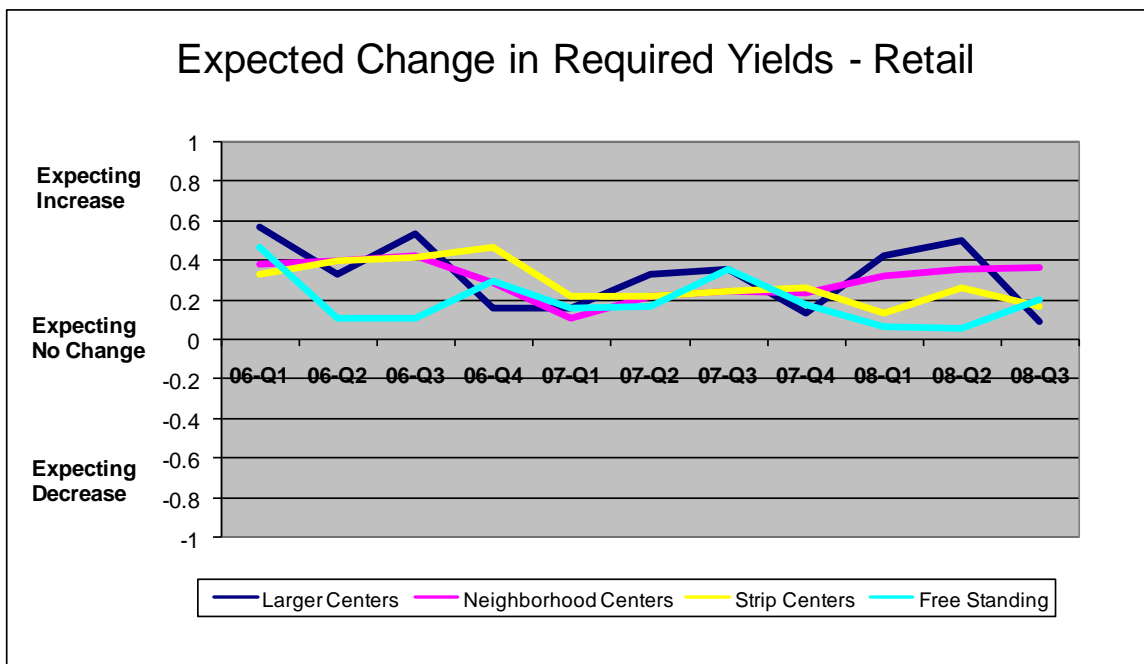
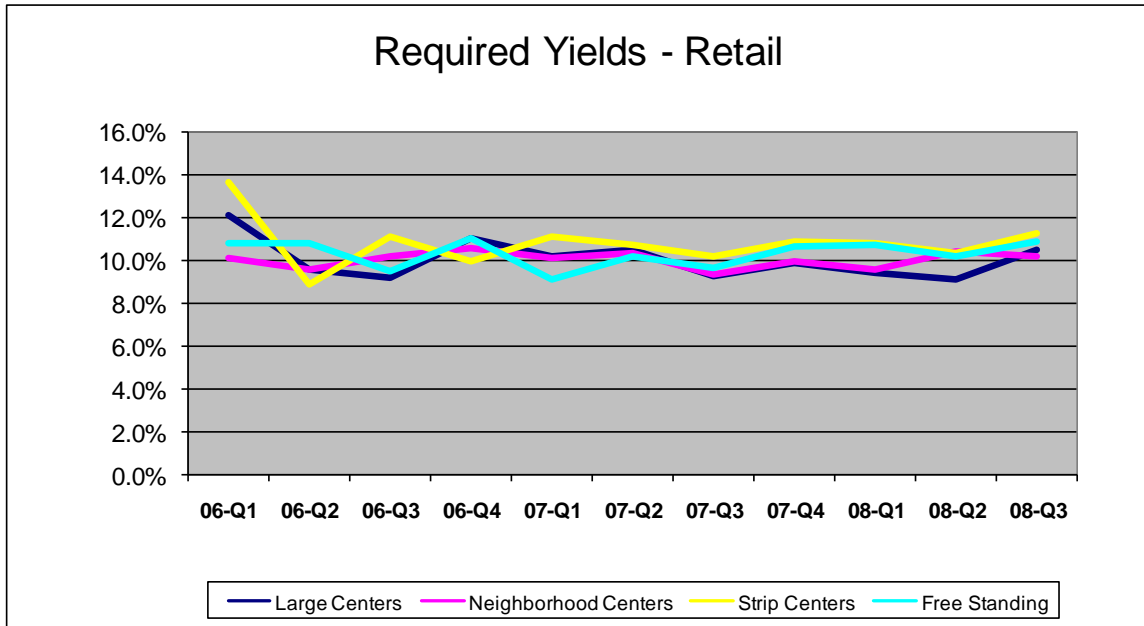
Cap rates have remained relatively unchanged this quarter. The highest cap rates are for strip centers, while rates for large retail centers, neighborhood centers and free standing centers have converged at approximately 7.5%. Despite the relative stability in cap rates over the past two years, most respondents expect cap rates to increase across retail classifications in the future.





**Yields**

While required yields for neighborhood centers, strip centers and free standing retail have remained relatively unchanged over the past quarter, yields for large retail centers have increased above the 10% level. With the possible exception of neighborhood centers, respondents expect yields to remain the same over the next quarter. The largest shift in expectations occurs for large centers, as respondents have scaled back their prior expectations of yield increases.



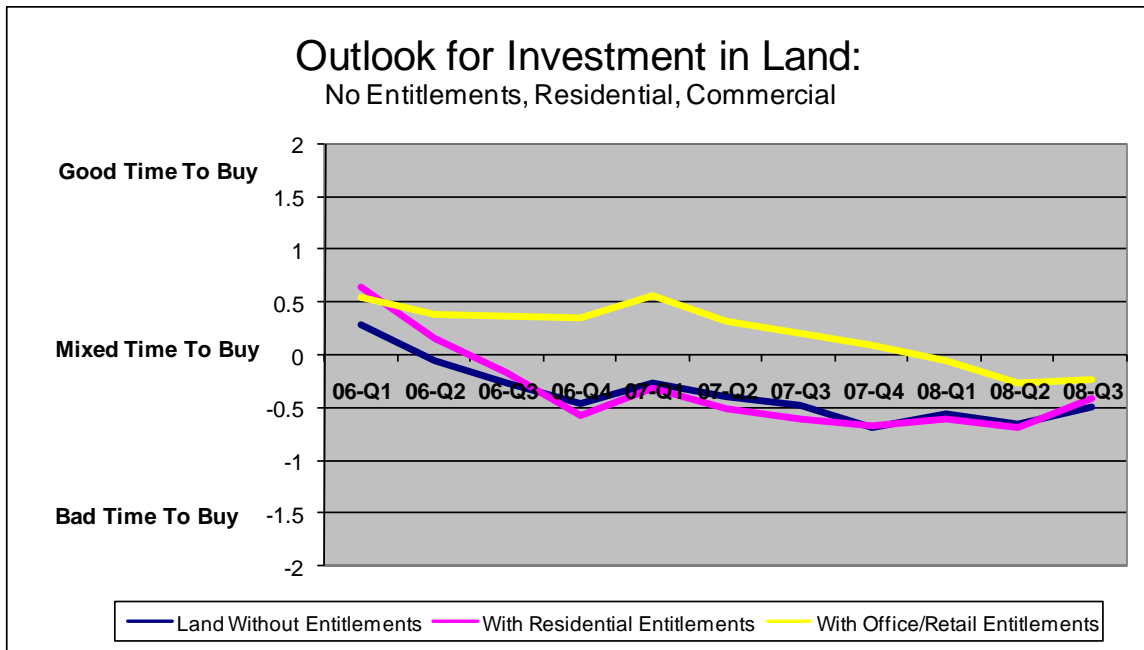
## Section 7: Outlook for Investment in Undeveloped Land

### *Land Without Entitlements or With Residential Entitlements*

The outlook for investment in land without entitlements or with residential entitlements remains relatively unchanged since last quarter as respondents continue to feel that it is a mixed time to buy.

### *Land With Office or Retail Entitlements*

The outlook for investment in land with office or retail entitlements has not changed since last quarter, possibly signaling the end of the decline that spanned the previous five quarters. Respondents still believe that it is a mixed time to buy.



**Land with Hospitality Entitlements**

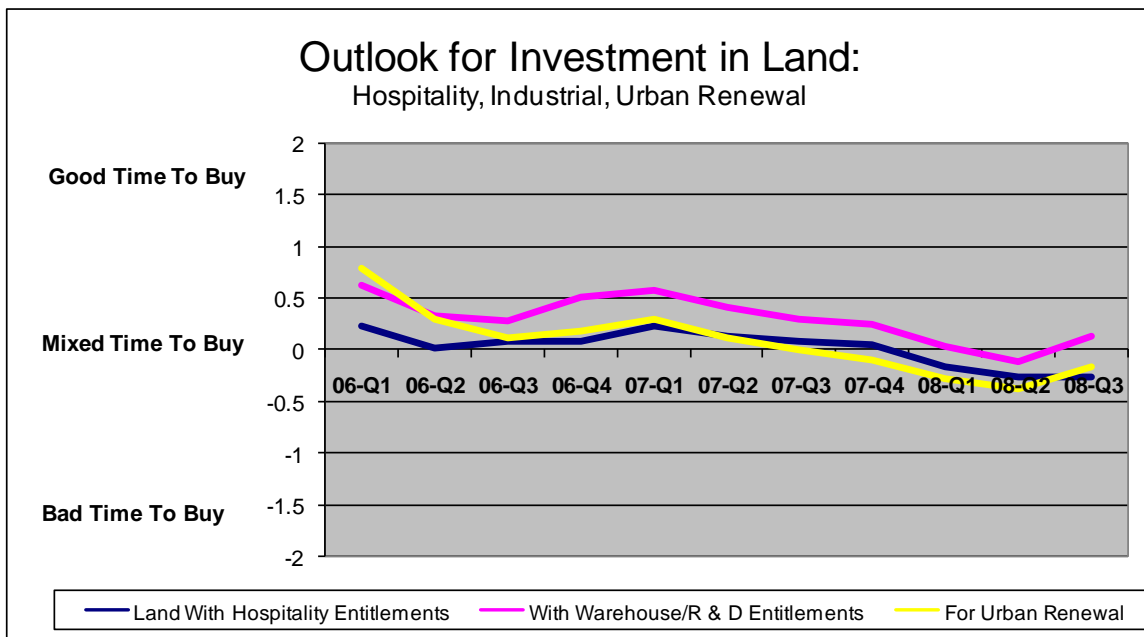
There has been no change in the investment outlook for land with hospitality entitlements over the past quarter. It remains a mixed time to buy.

**Land with Entitlements for Warehouse or R & D**

In contrast to the significant downward trend of the previous five quarters the outlook for investment in land with warehouse entitlements has become slightly more optimistic. It remains a mixed time to buy.

**Land for Urban Renewal**

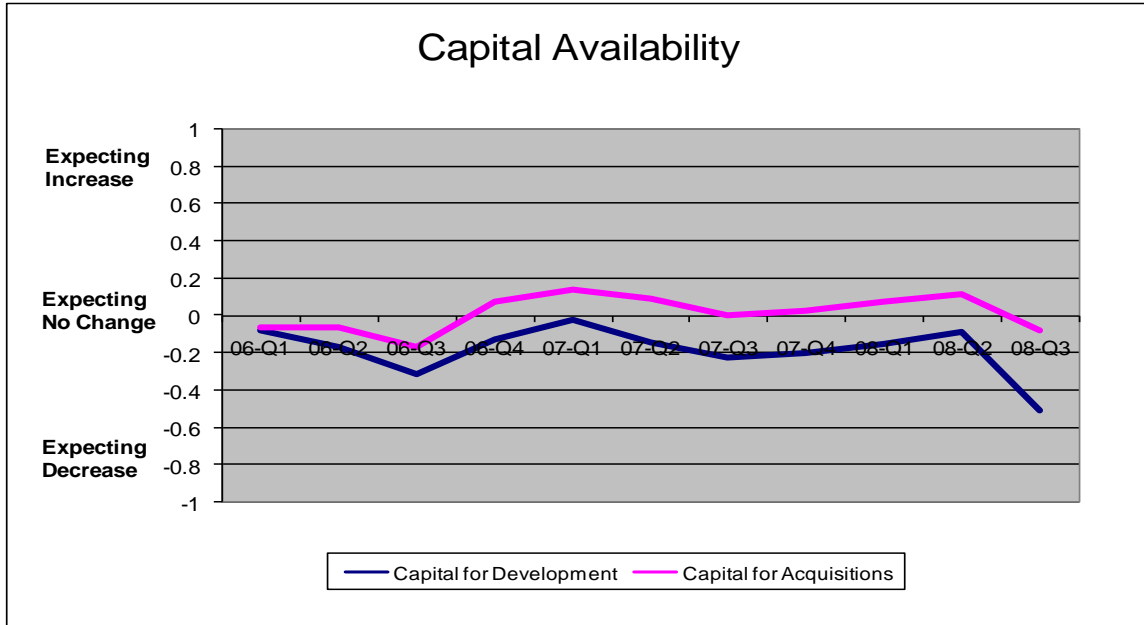
There has been little change in the outlook for investment in land for urban renewal over the last quarter. It remains a mixed time to buy.



## Section 8: Business and Capital Availability Outlook

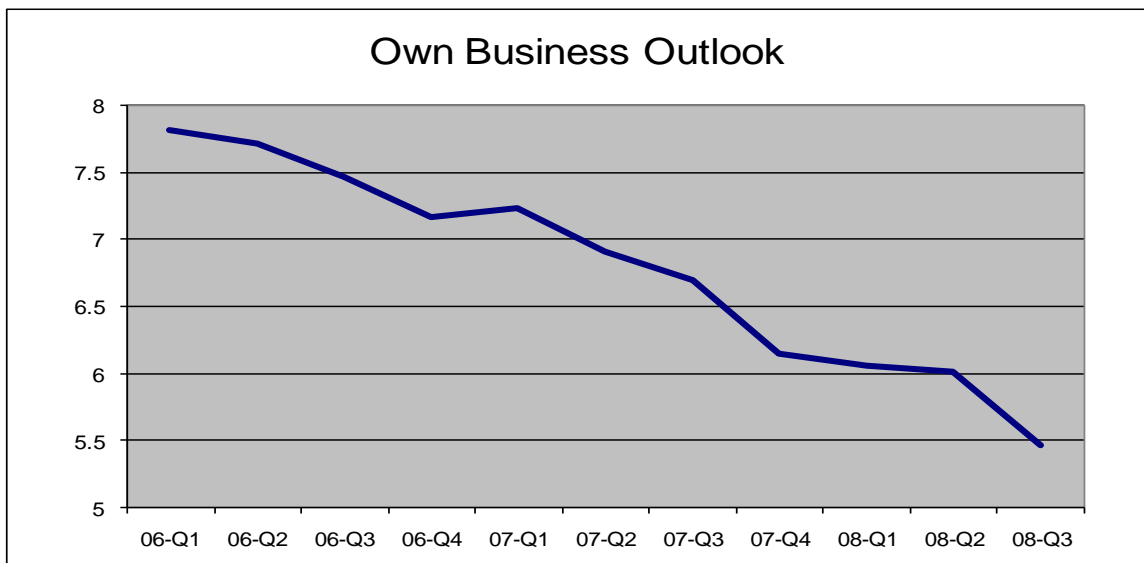
### Capital Availability

While the past year has shown little change in capital availability for both development and acquisitions, respondents indicate that there will be a significant decline in the amount of capital that is available for development in the quarter ahead. However, respondents still expect little or no decline in the capital available for acquisitions.



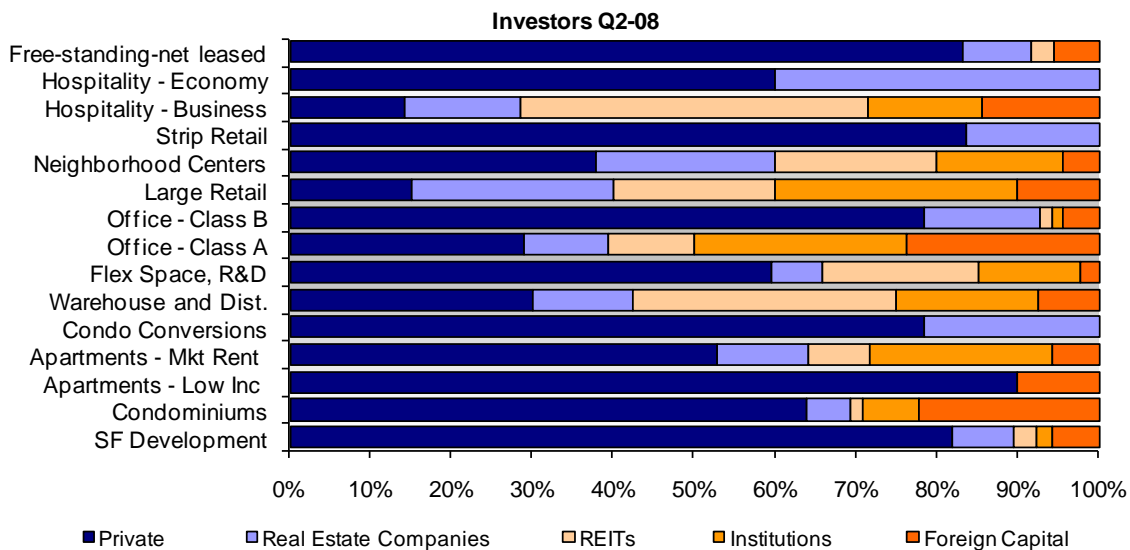
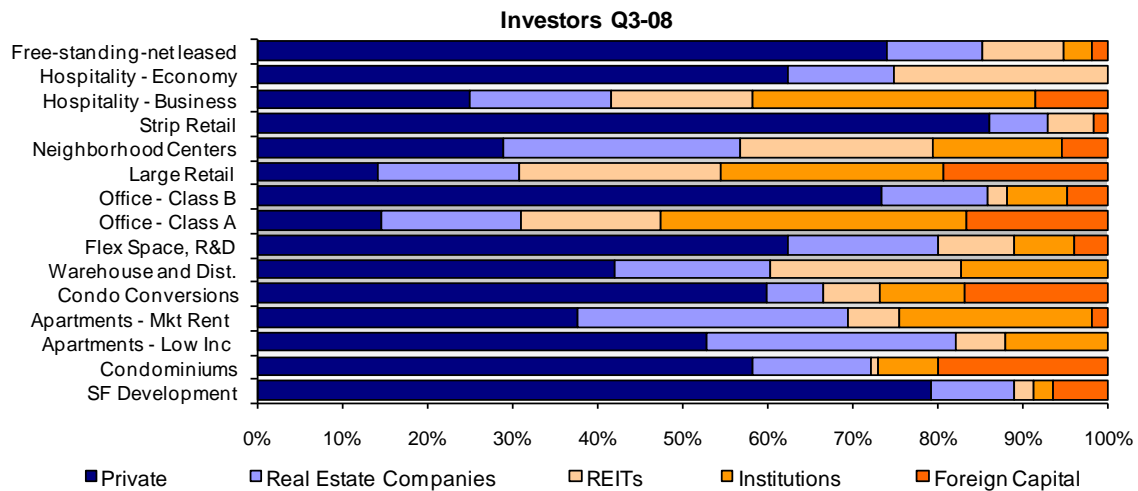
### Outlook of Own Business

Respondents' perception of their own business' outlook continues to grow weaker with each quarter that passes. Inadequate capital availability and the prospect of a long and deep recession may continue to fuel this decline.



## Section 9: Dominant Investors

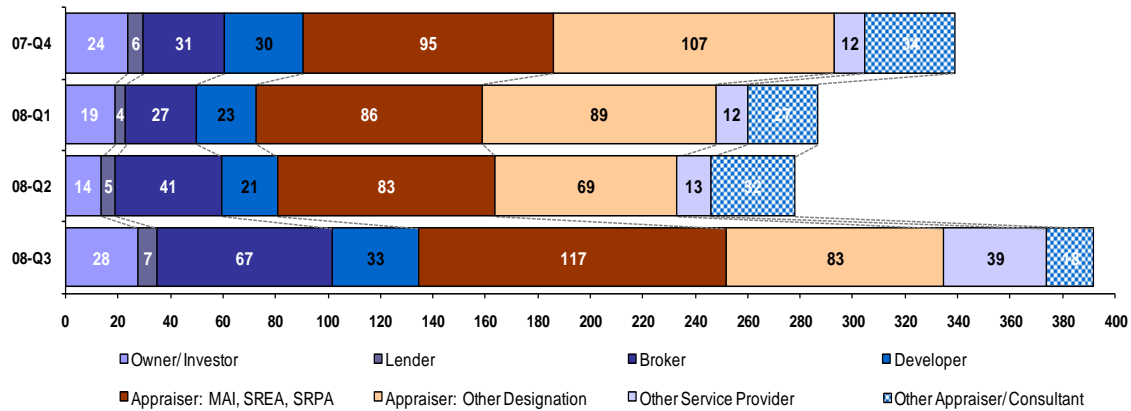
Respondents were asked to indicate which of five investor groups they perceived to be the most active for each type of property they analyze. For eleven of the fifteen property types, private investors were the most dominant. The exceptions include hospitality-business, neighborhood centers, Class A office and large retail. Investment in hospitality-business, large retail and Class A office appears to be dominated by institutional investors. Private equity, real estate companies and REITs divide the neighborhood center segment almost equally, with institutions and foreign capital playing a lesser role. The most significant changes in investor composition over the past quarter include the movement of REIT holdings out of the hospitality-business sector, the increased presence of foreign investment in condo conversions, and a reduction of private equity's investment in low income apartments.



## Section 10: Characteristics of Survey Respondents

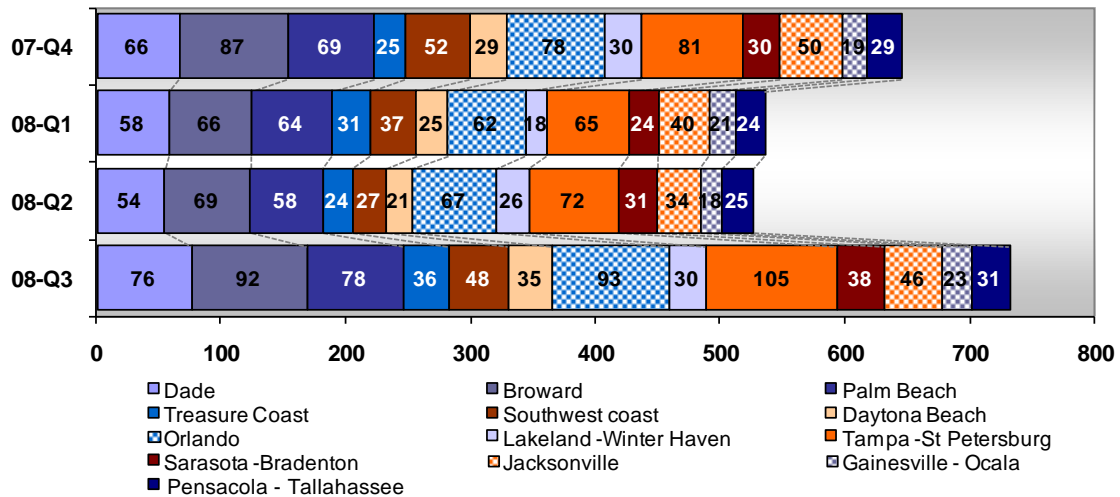
In the latest survey, approximately 51 percent of the 392 respondents reported being an appraiser; well over half with designations of MAI, SREA or SRPA. The next largest groups, each representing about seventeen and ten percent of respondents respectively, were brokers and other service providers.

### Profession of Respondents



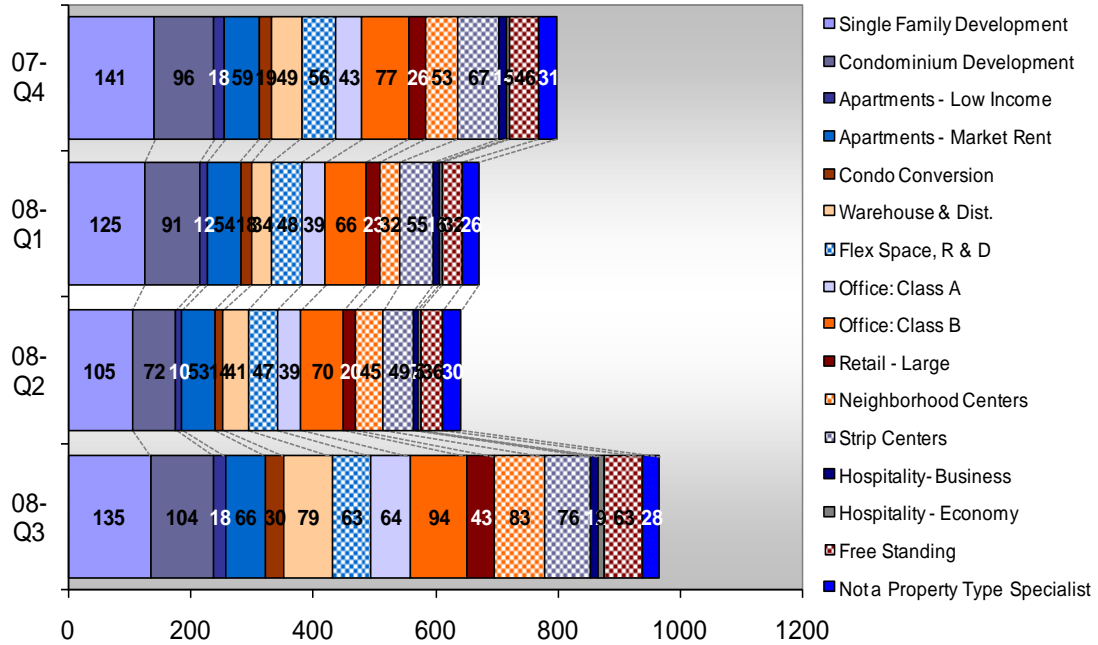
### Markets of Familiarity

Each respondent was asked to select up to four regional markets with which they are familiar. In the latest survey, these choices accumulated to 731 observations. Every region, with the exception of Gainesville–Ocala, was represented by a minimum of 30 observers, five of which had greater than 70 observers. The highest number of responses was for the Tampa–St. Petersburg market, which had 105 representatives. The lowest respondent support came from Gainesville–Ocala with 23.



**Property types of Familiarity**

Each respondent was asked to select up to three property types with which they were familiar. Altogether, 967 selections were made in the latest survey round. Single family development was selected by 135 respondents while condominium development was selected by 104. Ten property types were selected by at least 60 respondents.



## **Section 10: Details of Cap Rates, Yields and Expected Changes**

Table 1 summarizes estimates of cap rates and yields for twelve property types over the last four quarters of the survey. In addition, this table shows the distribution of expectations for changes in each reported cap rate and yield. In particular, the table reports the percent of respondents expecting each cap rate and yield to either rise or fall in the future. Excluded from this table is the percentage of respondents whom are expecting no change. This third percentage can be computed as 100 less the two percentages reported. Since prior sections discuss the content of Table 1, further comment is not given here. The table is simply provided as a reference to facilitate application of the survey results.



**Table 1: Detailed Cap Rates, Yields and Expectations for Change**

<b>Florida</b>	Apartments - Market Rental	Condo Conversion	Warehouse and Dist.	Flex Space, R & D	Office: Class A	Office: Class B	Retail - Large	Neigh- bor- hood Centers	Strip Centers	Hospitality Business	Hospitality Economy	Free Standing
<b>Cap Rates</b>												
<b>Q3-08</b>												
Q3-08 Value	7.5%	8.6%	7.7%	8.1%	7.3%	8.1%	7.4%	7.4%	8.1%	8.8%	9.1%	7.6%
Percent Expecting Rise	58.3%	48.4%	44.7%	53.6%	53.6%	42.5%	64.7%	47.1%	54.7%	50.0%	50.0%	42.9%
Percent Expecting Fall	0.0%	6.5%	5.3%	7.1%	0.0%	5.0%	2.9%	2.9%	6.3%	8.3%	0.0%	7.1%
<b>Q2-08</b>												
Q2-08 Value	6.6%	6.8%	7.5%	7.8%	7.2%	7.9%	6.9%	7.1%	7.8%	8.2%	9.5%	7.9%
Percent Expecting Rise	35.3%	30.8%	57.5%	59.6%	62.9%	55.7%	66.7%	48.9%	53.1%	40.0%	50.0%	44.4%
Percent Expecting Fall	9.8%	7.7%	5.0%	2.1%	2.9%	2.9%	11.1%	4.4%	4.1%	0.0%	0.0%	11.1%
<b>Q1-08</b>												
Q1-08 Value	7.0%	7.1%	7.0%	7.7%	7.0%	8.1%	6.6%	6.9%	7.8%	9.0%	10.1%	7.5%
Percent Expecting Rise	43.4%	27.8%	42.4%	40.4%	45.7%	37.5%	57.1%	51.6%	41.5%	37.5%	40.0%	40.6%
Percent Expecting Fall	5.7%	22.2%	3.0%	6.4%	2.9%	7.8%	4.8%	0.0%	5.7%	0.0%	0.0%	9.4%
<b>Q4-07</b>												
Q4-07 Value	7.0%	7.1%	7.6%	7.7%	6.8%	7.7%	6.6%	7.0%	7.9%	8.9%	10.1%	7.5%
Percent Expecting Rise	55.2%	47.1%	39.6%	45.5%	58.3%	35.5%	59.1%	58.8%	40.9%	38.5%	40.0%	37.8%
Percent Expecting Fall	1.7%	23.5%	2.1%	7.3%	0.0%	2.6%	4.5%	3.9%	1.5%	7.7%	20.0%	2.2%
<b>Yields</b>												
<b>Q3-08</b>												
Q3-08 Value	11.4%	17.2%	9.5%	10.7%	10.1%	10.6%	10.5%	10.3%	11.3%	11.4%	11.5%	10.9%
Percent Expecting Rise	41.5%	40.0%	31.3%	28.6%	36.2%	26.8%	38.7%	43.8%	32.1%	45.5%	42.9%	28.0%
Percent Expecting Fall	3.8%	13.3%	11.9%	12.2%	14.9%	9.9%	29.0%	7.8%	15.1%	9.1%	0.0%	8.0%
<b>Q2-08</b>												
Q2-08 Value	10.3%	19.1%	10.9%	11.8%	10.1%	10.8%	9.2%	10.4%	10.4%	12.3%	14.0%	10.2%
Percent Expecting Rise	21.6%	30.8%	30.0%	36.2%	42.9%	37.1%	61.1%	42.2%	30.6%	60.0%	50.0%	19.4%
Percent Expecting Fall	5.9%	0.0%	5.0%	6.4%	5.7%	4.3%	11.1%	6.7%	4.1%	0.0%	0.0%	13.9%
<b>Q1-08</b>												
Q1-08 Value	9.4%	18.6%	10.0%	10.0%	9.9%	10.4%	9.5%	9.6%	10.8%	11.6%	12.3%	10.7%
Percent Expecting Rise	28.3%	5.6%	18.2%	25.5%	40.0%	26.6%	47.6%	41.9%	24.5%	37.5%	40.0%	15.6%
Percent Expecting Fall	3.8%	27.8%	3.0%	8.5%	8.6%	10.9%	4.8%	9.7%	11.3%	0.0%	0.0%	9.4%
<b>Q4-07</b>												
Q4-07 Value	9.7%	15.3%	10.1%	10.1%	10.1%	10.9%	9.9%	10.0%	10.9%	10.8%	11.5%	10.6%
Percent Expecting Rise	44.8%	29.4%	25.0%	32.7%	36.1%	26.3%	36.4%	35.3%	28.8%	46.2%	40.0%	24.4%
Percent Expecting Fall	5.2%	5.9%	0.0%	3.6%	2.8%	3.9%	22.7%	11.8%	3.0%	0.0%	0.0%	6.7%