

REAL ESTATE DECISION MAKING – TRENDS IN CRE

Professor: Greg Smersh, Ph.D., Guest Speakers: Lou Varsames and Rick Colon

Our guest speakers today are Lou Varsames and Rick Colon with Cassidy Turley.

Lou is a veteran in the commercial real estate industry 20, 30 years. Rick is a graduate of USF and has been with the firm for--

Eight and a half.

Eight and a half years. So they're going about a couple of different things today. And with that, I'll turn it over to you guys.

Thanks, Greg. I appreciate it. Again, I'm Lou Varsames and thank you all for your time today. We're going to break this down into three 20-minute segments. The first segment is going to be to talk a little bit about our company. And then we're going to touch on the market as it relates to office space and industrial space. There's more we're going to talk about and other product types, but those are the two we primarily specialize in.

The second phase or a second chapter will be two case studies. And they'll both be actual deals that we've worked on here in Tampa. And then the last section we'll talk about careers and opportunities and some risk rewards on the different aspects of careers out there.

So with that, I'll start with myself. Again, I'm Lou Varsames. I've been in the business since 1983. I graduated college on June 23rd and then started working on July fifth. I moved to Tampa in 1985 to become a developer, which is also what I was doing from '83 to '85.

And we started company called Tower Mark and we built office buildings in West Shore, Rocky Point. And then we built industrial buildings on the east side of Tampa as well as north of the airport called Benjamin Center and Thompson Center if you've ever been north of Hillsborough on Benjamin Road in that area.

So in 1991, I switched over to CLW. And-- well, I'll get into that in a minute. Rick, why don't you go ahead and introduce yourself and then I'll jump back in.

I'm a Rick Colon. I graduated from USF in 2004. I actually took this course at one point and kind of had an interest in real estate. Followed up by going to UF for a master in finance. Got done there in '06. And CLW, who's the firm Cassidy Turley bought, hired me on in 2006, and I've been there, basically, ever since.

So my initial role as a analyst. I work to underwrite deals for our corporate services group, for our local brokers, industrial development. I underwrote everything that we acquired sold during that

time. After about five years, I moved to start negotiating some of my own deals on the corporate services side. We brought someone to take over a lot of the analyst roles.

And the last year and a half, since the merger, I've been focused more on capital markets, which is basically only institutional investment sales. That's kind of been our focus. It's a product offering that we never had under CLW. Now we have it under Cassidy Turley. So that's been a big focus for us.

OK. So we're going to talk a little bit about Cassidy Turley. We are a 4,000 employee firm. We have approximately 1,000 brokers nationwide. We handle all different product types.

Then you'll see on the left under real estate, we're involved in office, industrial, retail, multifamily, medical, office, senior housing, and land. So all product types that are out there, we have specialists in that area.

Our current core services is really being a service provider. We're not typically principles. In other words, we're not putting our equity in and having ownership, but instead we're representing companies and collecting a fee for that. So that's how we're differentiating, a service provider versus a principle, if you will.

So some of our core services are managing buildings, leasing buildings. We'll help owners build buildings. We'll represent companies. So we'll get into it in a little bit later, but Bristol Myers is a company that just recently moved into Tampa. We helped them do a natural search, settle on Tampa, and they're now employing or moving up to 600 employees.

So those are the type of projects we do. Again, as far as specialties, we pretty much cover every area of real estate that there is out there. And again, we're going to focus more on office and industrial for today. But just to give you a little bit more of a feel of what we have.

So I started a company in 1991 called CLW along with six other folks. And in 2012, we sold out to Cassidy Turley. So at the time, CLW was 25 million in revenues when we sold. Cassidy Turley was 700 million.

Cassidy Turley is now under contract by a private equity group called Texas Pacific. So if you were to Google them, you'd probably see some articles and so on on the merger. But they're going to buy Cassidy Turley on December 31, 2014. And then we'll become almost a \$3 billion enterprise with a global footprint.

Prior to the merger with DTZ and after our sale of CLW to Cassidy, this was our footprint. And actually that shows DTZ in here as well.

It's the greens.

But the green was Cassidy and the blue is DTZ. So obviously we really, from a national standpoint, had a great platform to work off of, versus CLW, which at the time was just one city, Tampa, one office. We were doing work nationally, but we wanted to get on a larger platform. So Cassidy Turley allowed us to do that.

We then-- I'm on the board of Cassidy and one of our goals was going from national to a global platform. And in the reason for this is-- and the reason I sold our company in 2012-- was our clients were telling us they wanted to have one single service provider to handle their work nationally. And then they started saying they wanted one service provider to handle the work globally. We weren't able to do it with one office in Tampa.

So initially, that's why we joined Cassidy Turley. The reason Cassidy Turley is joining with DTZ is because DTZ are all these dots in Europe and in China and in Australia and a little bit in Africa. And companies, again, like a Bristol Myers or Proctor Gamble or IBM.

When you provide services to them, ideally they want to have a one stop shop. They want to be able to go to a team like Rick and I and say, I want you to handle all our real estate. We want you to coordinate it globally. So that's why we moved to that platform.

So Cassidy Turley as of this coming December 31st will be one of the three largest companies globally in the world. Rick, you want to talk about the--

Sure.

Some market trends.

We want to touch briefly on some national office and industrial market trends. We're going to focus on just those because that's basically what we work on day in day out. And the font cut off a little bit here, so I'm sure I'll hit the last bullet.

So office space has slowly recovered. It's been gradual, but it's doing quite a bit better now. The most important factor in office space recovery is jobs. So national employment picture's gotten a lot better. We topped out about around 10.9% unemployment. Right now we're at 5.9 as of September.

Already this year we've created two million jobs. Now that's huge for office space. So 65 of the 80 markets that Cassidy Turley tracks are showing annual occupancy gains, which is a pretty good signal.

The national markets have absorbed 22 million square feet in the third quarter alone. The US office vacancy, as of most recent, has declined to 14.8%, which is 250 basis points below the peak that we saw in the recession in 2011.

Some of the best performing markets-- Dallas, Denver, San Jose. They're actually seeing employment which is 40% above their peak for the recession.

But then others-- Saint Louis, Detroit, Philadelphia. Those are still struggling. They're still far behind. Now nationally right now we've got almost 86 million square feet that's being built, currently under construction. To put that into perspective, that's about twice as much of all the office space that we have in all of Hillsborough County.

So it's quite a bit. There's a lot of space getting built. There's a lot of jobs that are being created. And the last bullet-- I don't want to miss it.

A lot of foreign capital. So key markets like New York, Washington, DC, Boston. Over half of the sales that are happening on institutional quality product is being bought by foreign buyers, which is a huge number there. Driving the yields down. They just need places to place their money and invest it and they're going for those large markets.

What we expect will happen in the next few years or so, they're going to start looking to more secondary markets like Tampa, Atlanta, and Miami.

On the industrial front, basically a different story than office. The industrial sector is absolutely booming. Every single region that we track showed gains in the last quarter. Employment for that sector grew by 102,500 jobs in the third quarter. To compare that to what it did to the third quarter of 2013 where it only increased by 30,700 jobs.

Also in that quarter, the industrial sector absorbed 41.6 million square feet of space. That's twice as much as the office absorbed in the last quarter on the previous slide.

Vacancy's doing a lot better than office. It's returned to its historical average of about 8%. The manufacturing sector is a big part of that. We're building cars. Energy.

Another big one is e-commerce. Alibaba just went public. They're about twice the size of the Amazon. They're going to expand throughout the US. That's going to bring a lot more upside to the US industrial sector because we're going to have to build more warehouses.

In terms of third quarter deliveries, we delivered 28.3 million square feet. So that means 28.3 million square feet were built and went out to the market. That's an increase of 40% percent from what we saw in the third quarter 2013. And much like office, foreign capital is being attracted to some of those larger markets.

So now we'll talk a little bit locally.

So in Tampa for awhile there, we were ahead of the national average as far as unemployment. And now we've shifted the other way. Tampa continues to be a great market as far as growth, primarily because of being known as a low labor area as far as cost.

So companies that, for instance, are in New Jersey and New York will continually look in Tampa because of the favorable labor climate, as well as the quality of life. We don't have the winters and we don't have the same tax structure. Not having any state tax is big issue as well.

So right now we're at a vacancy rate of 17%. When I started in the business in 1983, what was considered a healthy vacancy rate was 5% or less. And the perspective has changed over time. And in Tampa, if we were down to a 10% vacancy, I think people would consider that relatively very healthy because we're considered a very high growth market.

When I started, I started in Boston, which was a very mature market so there wasn't a lot of new supply coming on. So there was an expectation of a lower vacancy. So 17 is not as bad as the 25% it was a couple years ago, but it's still not where it needs to be.

The strongest market, even though the numbers don't show it, is really West Shore. That is still the most favorable market for office tenants to be looking at. And the reason is it's a great airport, it's great access. You can access employees and people that live all the way from the beaches all the way out to the east side of Tampa.

I think downtown, over the next 10 years, is going to be a very interesting opportunity and a big growth area in the office side. And we'll talk about that in one of our case studies.

Again, employment recovery continues. The national average was in the fives, we're in the sixes. Again, that flipped. Some of the companies that have recently moved in. BMS is Bristol Myers. USAA is a large insurance company primarily servicing the military. They're taking 420,000 feet.

Health Plan Services really took off because of ObamaCare. They're the group that would do all the processing when you go online you fill out an application. They're the ones doing the processing behind the scenes.

And then companies like Amazon, which I'll touch on in the industrial. Two requirements for a million square feet is what they added here to the Tampa market.

Again, downtown. The trend right now is to be able to live, work, and play in the same area if there's a preference. So I'll just ask you as a show of hands, if you had a choice to work in an area where you can pretty much walk to everything and live and work in the same area, how many of you would think that's preferable versus being in the suburbs?

Yeah. So this is a great indication of where I think things are going. This is happening across the country. Downtowns, even in the South and in the West, are becoming revitalized because younger people want to be more in an urban type of environment.

There's limited large blocks of space. So when you see comments like this, it usually means that you're going to start seeing some new development because if a company comes in and wants 100,000 feet or 400,000 feet and the largest block existing is 80,000 feet, then they have to have something built for them. So developers will try to get out ahead of that and build something speculatively in anticipation of the growth coming into Tampa.

Again, as Rick mentioned, the vacancy rates for industrial is significantly better at 8.4% overall. The strongest market is always right along I-75 and I-4. That's usually the distribution market within industrial.

So when you think of industrial, there's really two ways of thinking about. There's those large over the road trucks that go into dock high, which is like four foot high overhead doors to pull right into for distribution. And then there's what's called service center, which is grade level doors in the back and typically some office space in the front.

So there might be a medical equipment company that will have the sales in the front of their office space, but they still want to have inventory in the back. So they'll be in what's known as an office warehouse environment. That will be referred to as service center space.

The distribution space is that dock high where you see the big trucks. And they're typically located around major highway intersection areas like I-4 and I-75. So that distribution market is extremely strong right now. A lot of it is driven by the e-commerce that's going on out there with the Amazons and Zappos and companies such as that.

Home building. Home building, when it crashed in '07, '08, companies that were installing tile or cabinetry, they would rent space in these service center spaces. A lot of those companies just went out of business because the building just stopped on the residential side. So the vacancy rates for the office service center stuff went very high very quickly because of that.

That market is coming back strongly again. And so now these companies are again going ahead and leasing spaces throughout Hillsborough and Pinellas as well. And there's now some new speculative construction going on in east Tampa, and I think we'll continue to see that as well.

Same thing. There's one bullet missing here. Investments sales on both the office side and the industrial side are really high. And the reason is-- there's several reasons.

One, if you were going to try to buy something in Washington, DC, or New York City, the return you're going to get is going to be like a 4% or 5% return. So if something cost \$10 million for instance, the way it's going to be priced is that the net income will be a 4% or 5% return.

Investors are not finding that acceptable anymore, and so they're going outside of the core major cities looking for a higher return. So in Tampa, for that same product, you can get a 7% or 8% return.

Or as we'll talk about cap rates. Everyone familiar with cap rates? OK. So we'll get into that a little bit too. So the cap rates and the return on investments outside of major markets are typically higher, but on the same time investors usually view cities like Tampa that would be considered a second tier city as somewhat more speculative than being in a mature area like Washington, DC, or New York City or San Francisco. So there's movement into the secondary cities now on the investment sale side.

The other thing is that there's a lot more foreign capital that still views the US as one of the most safe havens for investing verses other parts of the world. So we're starting to see a lot of activity and a lot of sales going on.