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**STORE
AGE**
Realigning retail

California

BY MIKE SHERIDAN

In the City of Angels, JPI—one of the nation's largest luxury apartment companies—has begun development of three upscale multifamily communities totaling 908 units. "The Los Angeles metropolitan area remains one of the best markets for multifamily development in the United States," explains Stephen Dominiak, JPI divisional president and managing partner.

"These three urban infill projects are all in excellent locations—



Residential Development in California: Back to the Basics

WHAT HAPPENED to housing in California?

Many builders took their eye off the ball, says Joel Shine, president of Los Angeles-based CityView. "They forgot about the basics such as how to build efficiently, continually focusing on construction costs per square foot, how to have the right floor plan for the targeted buyer, and how not to overpay for the land," he says. "We also missed the impact of investors pushing up prices. We kept adding things to the house and charging more for them. Housing in California was so good for so long, many people simply forgot about their core mission: to create a place where people actually wanted—and could afford—to live."

Shine should know. CityView provides financing for America's urban homebuilders and has nearly a dozen residential developments in the Golden State alone. He notes that California's housing industry and industries supported by it are a big economic driver in the state. "If the industry continues to contract and values fall too far, the political entities that rely on property tax revenue will take a big hit," Shine says. "Government revenues will be down because property taxes are tied to values."

There will be a measurable impact on consumer confidence, particularly in neighborhoods where there are foreclosures and subprime problems. For most Californians, their home is their

access," he continues. "But I think the net is going to be—if the situation gets no worse—say, a 25- to 50-basis point backup in cap rates in prime properties in prime locations."

Professional service jobs and the tech recovery have boosted demand over the past three years for office properties, Nadji adds. "In the months ahead this will slow, but the sector has low vacancies, relatively moderate new construction levels with few exceptions, and revenue upside



The recently completed Renaissance development in Inglewood—financed by CityView in partnership with John Laing Homes—features 122 single-family detached homes. The project incorporates new urbanist design principles including tree-lined parkways, pedestrian-friendly pathways, and distribution of open green space in the form of small pocket parks.

single biggest asset. If you read in the press every morning that your largest investment is worth less than you initially paid for it, how motivated are you going to be to go out and spend money on a car or anything else?"

How to fix the problem? Go back to the basics. "Over the last ten years, homes sold themselves, so builders did not worry about the extra couple of bucks a foot on construction that they should have worried about," Shine continues. "Builders now need to know their buyers. Many sales representatives weren't well trained in the selling and/or marketing side of the business. You've got to determine what consumers want and what they can afford rather than follow the popular trend."

Residential developers also believed that rapid home appreciation would continue. "Some developers bought a deal that would work only if home

prices increased," Shine says. "Now, some homebuilders are cutting prices instead. Prices need to come down until they meet with a target price of buyers who can afford the homes and who have gained enough confidence in the market to jump in. But just reducing prices is a short-term strategy that will adversely affect the market and become a bottomless pit. If you drop your price by \$10,000, the builder next to you drops [his] by \$15,000 . . . and that's where you see markets heading south. Instead, builders and developers must be creative in finding new ways to differentiate their products outside of price. Perhaps redesigning the houses or working to get a better mortgage product could provide more positive results. The key here is to develop a keen understanding about how the housing landscape in California has drastically changed."—M.S.

in lease rollovers that will turn in 2008-2010," he continues. "Unless there is an unexpected severe recession, the office market should continue to perform well, but will be out of its 'recovery' mode and into a stabilization phase of the cycle. We remain concerned about Orange County's office market because of its above-average exposure to mortgage-related jobs."

California's commercial real estate markets are performing well overall, particularly in the core Los



Angeles and Bay Area areas, says Daniel J. Hogan, research director at Red Capital Group, a Columbus, Ohio, commercial mortgage and investment bank serving the multifamily housing industry. "Third-quarter office occupancy was higher than the national average in nearly every major market in the state, and absorption and rent growth were constructive," he says. "Vacancy in the retail sector was virtually nonexistent. Every major market in the state recorded an average vacancy rate of 6 percent or less in the third quarter—less than one-half of the national average."

Because income growth has been strong and most California markets are supply constrained, the retail sector is performing well. Retail vacancies have been low and rent growth has been very strong in recent years. However, Nadji expects retail to slow along with housing. "First, residential development

Developers Diversified Realty is constructing the 591,863-square-foot (54,986-sq-m) Mendocino Crossing mixed-use development in Ukiah. Upon completion in 2010, the project will be anchored by large-format retail, featuring national and regional specialty shops and restaurants and up to 100 of multifamily residential units.

will not be taking place; therefore, retailers will not have new communities and neighborhoods to expand into as they did over the

past five years," he points out. "Secondly, with the economy slowing and cash from refinancing homes drying up, retail sales will soften and more retailers will become cautious about expanding. However, we are not expecting a downturn for California retail real estate—rather, a slowing. The areas with the weakest housing/economic outlook for 2008 include Orange County, San Diego, the Central Valley, parts of the greater East Bay in the Oakland area, and, to a lesser extent, the Inland Empire and Sacramento. Los Angeles, San Francisco, and San Jose will lead the retail sector."

David Oakes, executive vice president of finance and chief investment officer of Cleveland, Ohio-based Developers Diversified Realty, says that the California retail real estate market is still solid and the company's outlook remains relatively optimistic. "Positive population and income trends



The Boulevard in Anaheim (above), a development of John Laing Homes, includes 56 new residences in a neighborhood newly designated for urban redevelopment. The 149-unit Arborwalk in Santa Maria (right, below) is a new-home community financed by City View. Virginia Terrace in San Jose (right, above), a development of Kimball Small Properties and Barry Swenson Builder, consists of 256 new condominium units ranging from 850 to 1,400 square feet (79 to 130 sq m). CityView acquired the project two years ago.

