

National Development Land Market

AS SUPPLY MOVES AHEAD OF DEMAND IN MOST PROPERTY SECTORS AND THE U.S. ECONOMY STRUGGLES TO REGAIN ITS FOOTING, DEVELOPMENT LAND OPPORTUNITIES WILL BE DIFFICULT TO FIND IN THE COMING MONTHS. "It is very hard to judge the market's movement right now," comments a participant. Plus, developers of commercial real estate are also facing higher costs for construction materials, labor, and the fuel used to run equipment. In addition, tighter debt markets and more stringent underwriting standards are not easy hurdles for many development land investors to overcome at the present time.

While all of these obstacles will limit the number of projects that developers start in the months ahead, they will also benefit the supply-demand balances throughout the industry by limiting additions to supply. "We've pushed back the start date on a few apartment projects given the amount of uncertainty we have with respect to how both the economy and the industry will fare over the next several months," shares an investor. So, while some developers have delayed projects, few have cancelled them. "Fundamentals are still quite sound, and many major markets can still absorb new space," notes another. The key, however, is to proceed with caution.

Some of the best development opportunities will likely be in the industrial sector, where deliveries have been

on a decline for the past couple of years. Given short lead times and quick completions, supply rarely gets too far ahead of demand in this sector. On the other hand, fewer development opportunities will exist in the retail sector, where many retailers have reduced store openings and scaled back on expansion plans due to weak consumer spending.

In the apartment sector, additions to supply are expected to rise over the next two years. Even though falling home values and stricter lending practices have increased the demand for rental units, most apartment investors view supply-side issues as the greatest short-term risk to this sector. Development land opportunities are also difficult in the office sector, where job losses and a skittish economy are keeping companies from expanding and leasing new or additional space.

DISCOUNT RATES

Free-and-clear discount rates including developer's profit range from 10.00% to 25.00% and average 17.50% this quarter (see Exhibit DL-1). This average assumes that entitlements are in place. Discount rates for projects that lack entitlements are typically increased between 300 and 600 basis points; the average increase is 450 basis points. An insufficient number of responses prevent us from reporting discount rates subject to financing.

ABSORPTION PERIOD

The absorption period required to sell an entire project varies significantly depending on such factors as location, size, and property type. This quarter, preferred absorption periods for participants range from 12 to 240 months. The mean absorption period is 60 months, or five years.

FORECAST ASSUMPTIONS

Growth rates for lot pricing vary due to local market conditions. Participants report an overall range from 0.0% to 12.5% with a mean of 4.0%. Over the near term, 50.0% of participants forecast lot prices to increase at the rate of inflation, while 33.0% of them project increases greater than inflation. The remainder (17.0%) expects increases less than inflation. Inflation growth rate assumptions range from 0.0% to 4.0% and average approximately 2.2%. ♦

Exhibit DL-1 DISCOUNT RATES (IRRS) ^a Second Quarter 2008		
	CURRENT QUARTER	FOURTH QUARTER 2007
FREE & CLEAR		
Range	10.00% – 25.00%	10.00% – 25.00%
Average	17.50%	17.21%
Change		+ 29

a. Rate on unleveraged, all-cash transactions; including developer's profit

Exhibit DL-2 GROWTH RATES FOR DEVELOPMENT EXPENSES	
EXPENSE	SECOND QUARTER 2008
INFRASTRUCTURE	
Range	3.00% – 3.00%
Average	3.00%
AMENITIES	
Range	3.00% – 3.00%
Average	3.00%
ADVERTISING	
Range	3.00% – 3.00%
Average	3.00%
REAL ESTATE TAXES	
Range	1.00% – 3.00%
Average	2.50%
ADMINISTRATIVE	
Range	3.00% – 3.00%
Average	3.00%
CONTINGENCY	
Range	3.00% – 5.00%
Average	3.67%
OTHER	
Range	3.00% – 3.00%
Average	3.00%