

# D-FW LAND ADVISORY

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Street Smarts For Cleaning Up In Real Estate

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## Does the REIT Retreat Mean "Lights Out" for D-FW Real Estate?

*Six weeks from now I will attend the MIPF Research seminar in hopes of learning the future of D-FW real estate. Chances are I could chunk a brick out in the audience and never worry about hitting anyone bullish over economic forecasts: as the storm clouds darken over world markets, a slow-down is eminent. Is it a blessing... or a curse? That's going to depend more on what you do... than what the economy does. Read on...*

From:  
Las Colinas, Texas  
Thursday, 9:42 a.m.  
October 15, 1998

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Dear Subscriber and Fellow Speculator:

I say it's high time quotas were established to limit our exposure to the volume and frequency of bad news.

The odious quantities spewed forth in just the last 30 days should be justification enough: the Oval Office Confession, the Stock Market Tailspin, the looming Congressional Budget Brawl, the Asian Crisis, the International Monetary Fund Crisis and now you can't help but wonder just how many countries there are left who *don't* have a Currency Crisis.

To worsen matters, there's the perception factor.

The kind that fouls things up good enough so that they actually get that way. Hardly a month ago Big-Project Lenders began behaving more in the manner of depositors staging runs on failing banks. Financing for spec office projects of the big box variety vanished in a matter of two weeks. Brought on no doubt by a good case of the oversupply jitters from all those construction cranes hovering along the D/FW horizon. The stock market did the rest.

Does this mean it's downhill from here for spec office builders?

I say yes... and no.

Yes... IF... you're one of the Big Guys using REIT money to build 200,000 square foot mid-rise projects for the 30,000-and-up square foot Fortune 500 tenant. For sure those guys'll have trouble finding bottom for

awhile. At least until stock prices regain some respect. Allow six months to a year.

And No... IF... you are among the Little Guys building 60,000 foot projects for the local orthodontists, plastic surgeons, family clinics, lawyers and title companies that need 2,000-10,000 feet. For players fortunate enough to be running in this niche, I say the REIT slow-down may have come along at a good time. Thing is, any worry that there might have been over competition or overbuilding seems suddenly to have been replaced by jubilation over having the Big Guys off the playing field for a while.

Let me explain: Maybe you didn't know, but all along, REITs have been financing projects using easy money... mainly Wall Street Money. Up until about a month ago, that is. In less time than it takes to straighten your sock drawer, bankers for these kinds of projects became as scarce as Russians without financial worries. To make a spec project fly now, The Big Guys are going to have to belly up to the bar. Cough up more equity. Show higher preleasing numbers. Qualify at local bank standards. The Big Guys now have to play by more of the same rules as the Little Guys.

SO: all said and done, this clamp-down has almost overnight leveled the playing field. And, for the first time since the REITs got to be a fashionable term among deal-makers, the slow-down spotlights just how quickly humbled REITs can be by economic dips. Thankfully, projects being financed through local banks are not as sensitive.

Not that it's news anymore, but across the country, REIT investments have been slowing for months now. Never mind that demand is stronger than ever for office space; even King-of-the-Hill Dallas is a harder sell compared to only a few weeks ago. Building purchases have declined, just-announced projects have canceled and fewer properties are being marketed for sale. During the first six months of '98, 111 office buildings traded in Dallas County, compared to 120 in the same period of '97.

A silver lining? No doubt this about face for funding REIT-sized projects can eliminate at least one worry. It cancels out any threat... real or perceived... of a D/FW office building glut.

SO: where are we... really? If you see buzzards circling, if double doses of St. John's Wort crossed your mind, allow me to present the True Picture as presented by a Money Raiser who's been "on the front" since '71.

### Perception Correction #1

**How Long REITs Will Be Down Doesn't Matter.  
It's How Ready Will You Be... When They're Back!**

So it takes a year. Maybe two. Fine. By then, I plan on having several projects up and running that'll make prime bait for REITs, starting with Premier Center in Las Colinas. Here's something else about REITs: After several years of paying big bucks for commercial properties in the Dallas area, REITs suddenly took stock and realized they were into Big D for a few billion. So now they're running around and buying properties in other areas of the country in a panic to show a more balanced portfolio to stockholders. Sure, Phoenix, Atlanta or Miami may get their biz for awhile—but before too long they'll be right back here in D/FW. Because in the end, there's no where else that offers D/FW dynamics. Make that Lion's Share Dynamics.

### Perception Correction #2

**Cheap Housing and Office Space Will Continue  
To Make D/FW The Promised Land For The Fortune 500s.**

Correct me if I'm wrong, but I believe it is D/FW that ranks 8<sup>th</sup> nationally in the category of cheap places to live. And Fortune 500s love us because we're so cheap on office space. No wonder. Maybe \$22 rents look

exorbitant here, but that's about half the going rate elsewhere, like San Fran and NYC.

Demand for D/FW office space almost doubled in the first half of '98. And in each of the last two years, new jobs created in D/FW... that would be 100,000. And experts say figure another 67,000 for this year. Hear the numbers, my friend.

So, demand. Absorption. Jobs.

Start there in your quest for curing perceptive disorders.

### Perception Correction #3

#### **And You Thought The Only Exit Strategy For Office Products Was REITs...**

If the stock market continues its downward spiral, most likely investors will look for alternatives to REITs and stocks. You know as well as I that REITs at 7-1/2% just won't cut it. There are better places to park money.

Like private investment in real estate.

But for big players, cross REITs off for now. In their place, write in pension funds and other institutional buyers. They'll be looking for higher ground. In fact, The Pension Real Estate Association (PREA) says most pension funds plan to increase the percentage of capital allocated to real estate by as much as 50% over the next five years.

*"Eventually, real estate will likely occupy a larger share of the pension fund asset mix. As returns continue to improve and particularly if the stock market falters, it's not unreasonable to expect real estate shares to approach that of the investable markets universe, which can vary from 5% to 25%..."*

That from a recent article in the PREA journal.

Back yard proof: Teachers Insurance & Annuity Association of America recently forked over \$120 million to purchase the almost-fully leased Millennium Center office complex in Las Colinas. "The purchase represents the pension fund's biggest purchase in Las Colinas since '89, when it paid \$290 million to buy unfinished portions of the project," *The Dallas Morning News* recently reported.

BUT: from here... where?

Every market cycle has opportunities, but this time around it isn't auction-priced bargains of five years ago. Even those who don't know real estate don't have to be told where the Sugar Daddies are now. Even if REITs *are* out for now, the real money is still in selling to Daddy Big Bucks. No-Names who hardly know a cap rate from an interest rate are making money hand over fist doing just that. Building whatever Institutional Money will buy.

At the top of their list are Premium Corporate Addresses like Las Colinas. While this trend will have its ups and downs, we're here to tell you it's huge, it's here to stay, and that in the end, the only big losers will be those who sit as spectators while this Fortune-Making Machine rolls ever on.

I suggest manufacturing Super Duper Institutional Money-Magnets. And that starts with understanding Quality Cash Flow, which is derived from a simple formula:

## Quality Location & Construction + Quality Leases = Quality Cash Flow

Quality Location, meaning high-income neighborhoods populated by professionals who want to office only blocks from their home, i.e. Hackberry and Las Colinas.

Quality Construction, meaning projects that have that classy feel which distinguishes them from their neighbors.

Quality Leases meaning five, ten and fifteen year terms that don't default even in rocky times. Stabilized leases, that show good performance history. After all, it isn't buildings or land that buyers of office projects are after. It's income. Cash cows. Endless streams of money, as close to worry-free as possible.

That's quality cash flow.

So, my friend... build, lease, stabilize, sell. Street Smart builders closely monitor cap rates (a fancy formula for sizing up a project's income), because some time back they figured out that you can build on a 12-13% cap, and sell at 9-10%. The 2-4 point spread can quickly turn Yahoos into Multi-Millionaires.

Yahoos... like you. Like me.

The time has come to close this issue and get back to biz, so listen up. For now, brace up. With so many moving parts to this Global Economy, let alone the speed, who knows where rental rates and cap rates will end up. I say now's a good time to stick to our knitting... to what we know. And what we know is, the D/FW economic dynamics are too strong to be wiped out by false perception. One reason is, D/FW is nothing less than a super-magnet to consumers of office space. Ditto when it comes to housing for employees. That's why Fortune 500s keep on moving here, good times or not.

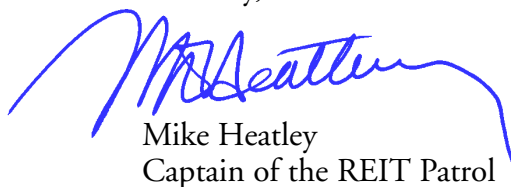
As for the REIT debacle, I see the timing as good. Good if you're building now and want to be up and running in time for their return. For the Little Guys, this is a window of opportunity to increase marketplace presence before The Jolly Green Giant gets back from vacation.

LAST: maybe I should mention that in the next decade, pension funds are expected to pass \$4 trillion. Let's see now... a mere 7% shift back into real estate... that would be an extra...

**\$280 Billion!**

Be ready.

Sincerely,



Mike Heatley  
Captain of the REIT Patrol

P.S. Don't come crying to me if you had to put retirement off another two years. In my last issue, I warned of a Goldilocks Market crashing to earth. Well, here we are bouncing along at 7,000, where we hope bottom is. We've bumped twice, some say it'll take once more to test for *true* bottom. If it holds, equities could be on their way again to making up serious lost yardage. Not long after that, REITs. We hope. Meanwhile, thank your lucky stars that Easy Money Deals are out of fashion, the foam is off the beer, and that nothing stupid happened. The last thing we need is another 80s-style market where real estate was Wily Coyote racing off the edge of a cliff long before noticing he'd run out of real estate. The "Oh, My God!" market. That's not us, and won't be as long as absorption is the beat to which builders, investors and developers dance. What to do: now that we're in uncharted economic waters, I say sit on it until the 401K reports come out. That'll tip you off whether there's any truth to all these siren songs about the economy.