2009 Commercial Real Estate Forecast

Looking more positive than the Lower 48.

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With many of the national commercial real estate markets in turmoil, national and regional market participants, including investors, developers and lenders, are following Alaska's real estate trends closely. One question frequently asked by our national clients is; "How is the market doing in Alaska?" If by the term, "Alaska," one means the entire state, then unfortunately there is no simple answer. Like the climate, geography and people, the Alaska commercial real estate market is extremely complex and diverse.

The high price of commodities insulated Alaska from the national recession throughout 2008 and statewide employment grew at a healthy rate of 0.7 percent. With the precipitous fall in commodity prices, Northern Economics and the Department of Labor forecast that Alaska will have negative employment growth of 0.6 percent and 0.2 percent, respectively – the first decline since 1987. In the current economic environment, the forecast dip in employment is viewed by most economists and members of the business community as relatively positive news – after all, this is a bump in the road compared to what most regions of the country are experiencing. Based on this information, here is what to expect in the commercial real estate markets for 2009.

Availability of Capital

Since 2000, the availability of capital in Alaska has been at historic highs. Alaska is not immune to global finance conditions, and thanks to excesses on the part of our friends in the Lower 48, the availability of capital has been significantly reduced. Fear not – in Alaska, capital will not disappear altogether and this reduction is best viewed as a return to condi-

Vacancy Rates: Anchorage Vs. National

	Anchorage		National
Office	5.5%	vs.	14.7%
Industrial	2.9%	vs.	12.1%
Retail	4.0%	vs.	7.1%
Multifamily	4.7%	vs.	6.1%

Source: Reliant, LLC, Bob Martin, AHFC, CBRE tions more typical of the 1990s. Chris Anderson, deputy director with the Alaska Industrial Development and Export Authority (AIDEA), indicated they have significant funds available in their loan-participation program, but that interest rates have trended upward over the last year to a level more in line with the prevailing rates of 2002. AIDEA reported a very low default rate of less than 1 percent and it has not noted any increases in defaults over the last year. Other lending institutions interviewed noted that they were doing deals, but at more conservative terms than in the past. Sound projects with preleasing and companies with strong balance sheets will continue to be financed, but the number of speculative projects and lending to speculative companies, will be reduced. The market has come full circle, and having a relationship with your banker will once again be critical for achieving real estate success.

Anchorage, Palmer and Wasilla

Despite the delivery of over 410,000 square feet of space and Anchorage's first two high-rise office buildings in 20 years, Anchorage office vacancy remains at 4 percent for Class A product, 7 percent for Class B product and 5.5 percent on a blended basis. This indicates a tight market for Class A and a healthy market for Class B. Only 12 percent of 2008 deliveries remain available, indicating a strong rate of absorption for new construction. New supply will be limited to Alaska Railroad's historic freight shed, consisting of 36,000 square feet of Class B space. No new Class A product will come online in 2009. Given the tight market, there will be upward pressure on Class A rents, particularly for blocks of space greater than 15,000 square feet. Class B product should experience rental increases, but at a more modest pace than for Class A.

Palmer and Wasilla currently have a vacancy rate of around 6 percent, and will experience limited new supply and demand indicating more of the same for 2009.

Retail vacancy is currently at a very healthy rate of 5 percent. New 2009 supply is significant and includes additional big box and shop space at CIRI's Tikahtnu Commons totaling 550,000 square feet, a 170,000-square-foot south Anchorage Target, and a 16,000-square-foot strip-retail center being built by JL Properties at O'Malley and Old Seward. Recent and expected expansion activity by nationals includes Lowe's, Best Buy, Wal Mart, Kohl's, Men's Warehouse, Sports Authority, Target (three locations) and Walgreens (two locations).

Look for the expansion by nationals to come to a virtual standstill. Gottschalks is currently in bankruptcy and may end up closing. Unlike the Lower 48, disposable incomes in Alaska remain healthy; however, new retail expenditure in 2009 will be limited, resulting in flat demand. In recent years, Alaska retailers have enjoyed sales volume 20 percent to 30 percent higher than national averages.

2008 Multifamily Vacancy

Market	Rate
Anchorage	4.70%
Palmer	5.60%
Wasilla	5.60%
Fairbanks	10.60%
Juneau	5.50%
Sitka	11.90%
Ketchikan	7.10%
Alaska Average	**6.70%**

Source: AHFC

However, the retail business climate will be highly competitive in 2009, and there may be some downward pressure on sales/square foot. Over the next year, this competitive business climate is not anticipated to have a major impact on existing product, and vacancy rates for first- and second-tier product that is stabilized will not change significantly. Conditions will be fairly uniform throughout these communities. Overall, don't expect 2009 to be a banner year for retail, but the market should remain healthy.

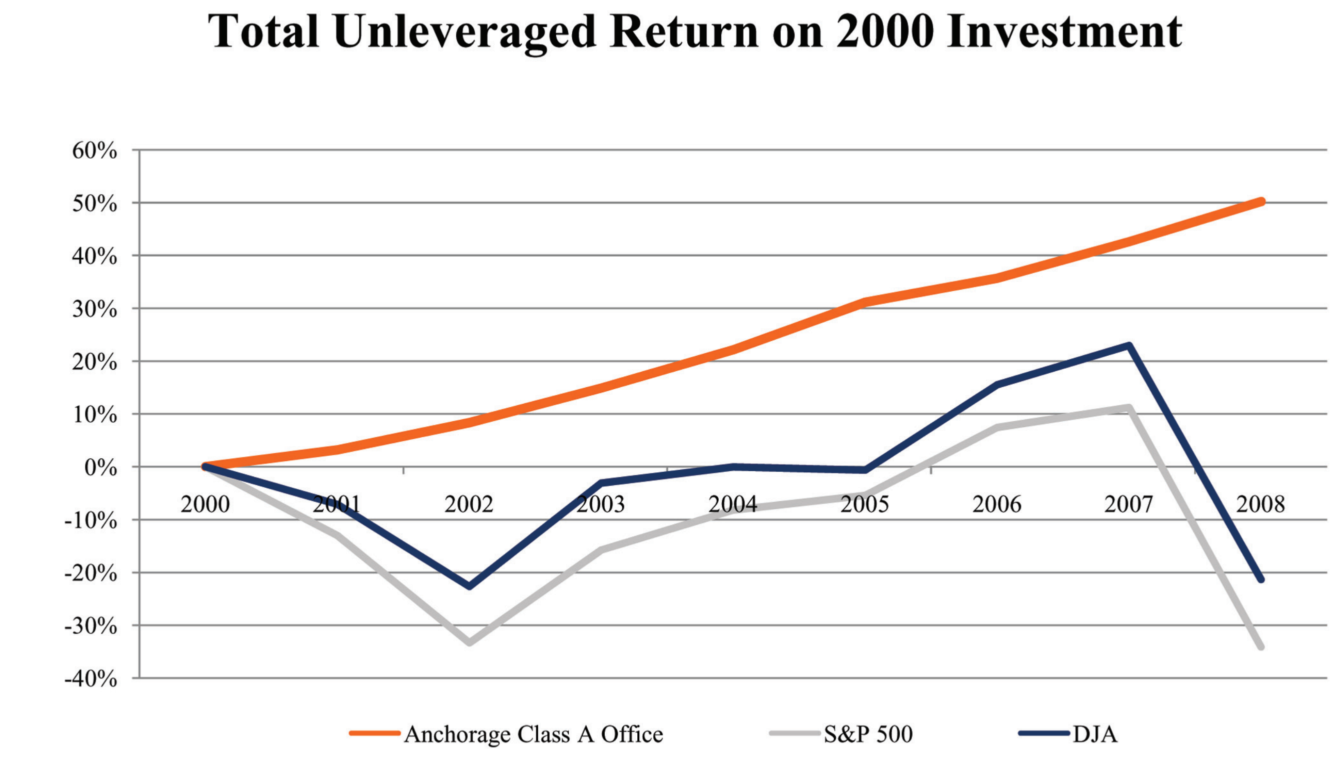
Bob Martin of Ravenwood Real Estate indicates that the Anchorage industrial market is very tight with a vacancy rate of only 2.9 percent. Due to high construction costs, limited new industrial product will come on line in 2009, and the only major scheduled delivery is the Unique Machine building totaling 66,000 square feet. Based on employment trends, demand for industrial space is projected to be flat. This should result in stable vacancy rates. However, given the tight market, look for continued healthy increases in rental rates. Due to a soft construction industry, Palmer and Wasilla have seen upward pressure on vacancy rates over the last year, and year-end rates are around 5 percent to 7 percent. These communities will experience limited new supply and demand indicating more of the same for 2009.

Fairbanks

Market participants reported vacancy rates of 5 percent for office, 2 percent to 5 percent for retail, and 5 percent for industrial, indicating all three markets are currently healthy. The office market inventory has been relatively stable for the last five years. Similar to Anchorage, the retail market experienced an influx of big box and national retailers over the last decade. The industrial market has expanded at a rate supported by economic growth, and recent projects in the area have included a truck-shop facility for Kenworth, a dealership for John Deere, a warehouse for Airport Rentals, a cross-dock warehouse for Food Services of America and a warehouse for United Rentals. New supply for all three markets will be limited in 2009 – in particular for office and retail. New supply of industrial projects includes a complete dealership facility for NC Machinery and a new truck-shop facility for Alaska Waste. Demand for these markets will be fairly flat for 2009. This should result in stable vacancy rates with slight upward pressure on rental rates for these markets.

Juneau, Ketchikan and Sitka

Market participants reported a vacancy rate for the office market between 5 percent to 7 percent, which is



Source: Reliant, LLC, MOA Tax Records & Yahoo! Finance

considered healthy. New supply will be limited in 2009. The office markets in these communities are highly dependent on government, which is one of the few sectors of the economy expected to experience modest employment growth. This should result in stable vacancy rates with modest upward pressure on rental rates.

Market participants report a blended retail vacancy rate around 7 percent; however, market conditions vary widely by city and type. In most cases, enclosed malls are experiencing high vacancy rates. There is limited availability of prime big box, strip and neighborhood commercial space. New supply will be limited and demand will be flat, suggesting no major changes in market conditions for 2009.

The steeply sloping geography and limited amount of level, developable land continue to have a major impact on nearly all segments of the Southeast real estate markets. This is particularly true for waterfront industrial property, where the available inventory is somewhat fixed. The industrial market continues to remain tight, with market participants reporting vacancy rates between 3 percent to 5 percent. New supply will be limited and demand will be flat, suggesting no major changes in market conditions for 2009.

As shown above, Alaska Housing Finance Corp. (AHFC) reports average vacancy rates for Alaska at 6.7 percent, which indicates a healthy market. Anchorage, Palmer, Wasilla and Juneau have very tight markets. Ketchikan's market is healthy and in equilibrium. Fairbanks and Sitka have higher vacancy rates than most other communities and have some excess supply. Look for most markets to experience limited changes in supply with slightly positive demand. Why will demand likely be positive? The answer is that population growth is forecast to remain positive, in part due to our state's relatively attractive economic environment, and demand for multifamily often increases during times of soft employment. Despite the forecasted softer economy, look for downward pressure on vacancy rates and moderate upward pressure on rents (with the exception of Fairbanks and Sitka, where rents will be flat).

Cruise Ship-Dependant Retail

Over the last decade, Alaska cruise ship-dependant retail has been one of the leading real estate market segments in the country. The highest land values in the state are not in downtown Anchorage – they are adjacent to the cruise ship berths in Southeast Alaska, where sales have been as high as $400 a square foot for prime, smaller sites. Vacancy rates for cruise ship-dependant retail have trended upward but still remain below 5 percent. Market participants have wisely recognized that the historic, high-passenger growth rates will not continue forever, and new supply will be limited in 2009. The cruise ship-dependant retail market is widely viewed as being more vulnerable to the national recession; however, cruise ship visitors to Alaska were up 0.3 percent in 2008. Early indications have been a decline in bookings for 2009 between 5 percent and 20 percent for many businesses. No reduction in cruise ship calls is anticipated for 2009; however, and an examination of recent history and other markets indi-

2009 Real Estate Outlook by Area & Product Type
First & Second Tier Product

Market	Anchorage, Palmer & Wasilla			Fairbanks			Juneau, Sitka, Ketchikan			Rural / Small Community		
	New Supply	New Demand	Rank	New Supply	New Demand	Rank	New Supply	New Demand	Rank	New Supply	New Demand	Rank
Office	Lim.	Lim.	4.00	Lim.	Lim.	2.80	Lim.	Lim.	3.25	Lim.	Lim.	2.75
Industrial	Lim.	Lim.	4.00	Lim.	Lim.	2.80	Lim.	Lim.	2.70	Lim.	Lim.	2.50
Retail	Sig.	Lim.	2.50	Lim.	Lim.	2.25	Lim.	Lim.	2.25	Lim.	Lim.	2.25
Multifamily	Lim.	Lim.	3.00	Lim.	Lim.	3.00	Lim.	Lim.	3.00	Lim.	Lim.	2.50
Lodging	Sig.	Neg.	2.50	Sig.	Neg.	2.25	Lim.	Neg.	2.25	Lim.	Neg.	2.25
Vacant Land	-	Lim.	3.00	-	Lim.	2.75	-	Lim.	2.75	-	Lim.	2.75
All			3.30			2.70			2.70			2.50

cates that, if required, the cruise ship companies will significantly discount prices in order to maintain passenger volume. Based on this model, while 2009 may not be a banner year, passenger volumes will likely remain at healthy enough levels to support the existing tourist infrastructure. Look for slight increases in the vacancy rate and stable rents, but for the market to remain healthy.

Lodging / Hotel

While there are many properties with strong performance, the national recession, a reduction in the number of independent travelers, and significant new supply coming on line resulted in a softening of the lodging market in 2008, with modest downward pressure on average daily rates (ADR) and occupancies at some properties. The expansion of the lodging market will continue in 2009, with roughly 400 new rooms coming on line in Anchorage and roughly 250 new rooms in Fairbanks. The consensus of market participants is that due to the soft national economy, demand will fall in 2009. As a result, the economic pie will likely be smaller and divided among a larger number of competitors. Keep in mind that this market has shown significant resilience in recent years. For the lodging industry the motto "If you build it, they will come" has in large part proven true, and under similar conditions over the last decade, it has more than once landed on its feet. Overall, don't expect 2009 to be a banner year for ADR and occupancies, but the market should remain healthy.

Alternative Investments

As shown in the adjacent chart, since 2000, the Class A office market has dramatically outperformed alternative investments. In light of double-digit losses in the stock market, the 7 percent to 9 percent return provided by real estate is attractive. This explains why, despite the uncertain environment, national real estate return requirements have increased only slightly over the last year. In a recession, the primary goal of investors is capital preservation. Because of this, demand for properties leased to high-quality tenants with a minimum of 3 years to 5 years remaining on the term will continue to increase.

Conclusion

The 2009 real estate forecast organized by area and product type is shown on the chart. The rank for the entire state is 2.9, which is slightly below a "neutral" ranking. Relative to the Lower 48, Alaska's commercial real estate markets are stable and healthy and are well positioned to weather a year of potential negative employment growth – should one occur. The longer term prospect of a natural gas pipeline, combined with the stabilizing influence of the State and federal governments, suggest that Alaska real estate may be better positioned for capital preservation and growth over the next several years than the Lower 48, as well. This forecast may not be as rosy as we would all like, but compared to what is going on in the rest of the country (see national vacancy rates), we are truly fortunate. In conclusion, if the economy is an ocean and the present national economic environment represents a severe storm, then Alaska commercial real estate is probably as seaworthy of a vessel as you are going to find over the next year. ❑

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