

# Commercial Crossroads



By Alan Callioni



The following is an excerpt from my article "Commercial Crossroads"

In a harrowing environment where vacancies continue to rise, while rents and values continue to fall, more and more commercial landlords are realizing massive losses.

Even sophisticated, established players find themselves in uncharted waters. How does one navigate a purchase or sale in this climate?

## The Situation

Declines in property values will even-

tually reach 35 - 50%+. Lenders have been accumulating an unprecedented number of REO properties as more owners with negative equity walk from their obligations. Propped up temporarily by government programs and creative accounting, lenders must eventually release properties onto an already flooded marketplace. Since 2008, hundreds of banks were taken over by the FDIC due to bad real estate loans. There are \$250B - \$300B in commercial loans coming due each year through 2015, many "underwater". However, few lenders are willing to refinance, so many borrowers will need to give up their properties and lenders will take enormous write downs. The recovery will be especially weak given the specter of rising interest rates. In addition, the timing of the recovery is an enigma, but most agree there will be no significant improvement until mid 2011 and possibly early 2012.

## If You Need to Sell

If you're facing a negative equity situation, you have a number of options, but most are painful: short sales, obtaining a principal reduction on your mortgage and voluntary foreclosures. Having an assumable mortgage generally makes a property more marketable. With a conventional mortgage, you could possibly offer a wrap mortgage to a buyer. Consider an online auction with reserve pricing. Every situation is unique. Use us

as a sounding board before you act.

## If You Want To Buy

Cash buyers who time this cycle correctly will become the new titans. For those savvy individuals with determination, patience and abundant cash, there are grand rewards.

This is an unprecedented time to acquire properties at low prices. During the boom, the biggest mistake was buying too late, now it's buying too early. Distressed properties abound, however, few are worth their current asking prices. Prices for most assets WILL drop further and your opportunities will expand, so investors are wise to be selective. REO properties aren't automatic bargains, even at half the appraised value. Use caution and be pragmatic about a turnaround. Remember, sales/lease comps from the bubble years of 2006-2008 are of limited use.

## How To Invest

Buy only significantly discounted property regardless of its income or "prime" location. A low basis will give you latitude to compete effectively. Understand that no tenant is too big to fail. Factor in 12-15% vacancy. Have significant reserves available. Once you own it, petition to get the property taxes dramatically reduced. We've done this numerous times. Speak to a skilled broker who specializes in the asset class you seek.

Some sophisticated investors don't wait for foreclosures, but rather circumvent the process by purchasing delinquent mortgages from the lender and then effect a foreclosure on the property. It's often a trickier play, but offers some advantages and is usually worthwhile. Speak to us about the techniques and strategies we've used to guide you through the paperwork maze.

## Where to Invest

**Apartments:** Typically the first asset class to recover. Focus on infill, A and B quality projects near mass transit. Best bets: Seek partially completed, mostly vacant, failed condo conversion projects or university housing. Remember, most would-be home buyers now need significantly larger down payments and face stricter qualifications. Many will be forced to rent.

**Retail:** Retail faces a brutal landscape. Best bets: Grocery anchored centers. Many small retail centers will not make it and will have to be repurposed. Even at historically tempting buy prices, be highly selective. Avoid tertiary markets and marginal locations.

**Office:** As they've been beat up the most, suburban markets will generally feature the best deals. Best bets: Medical. Focus near hospitals, assisted living and retirement communities. As baby boomers hit retirement age and Obamacare starts, medical space will be in higher demand.

**Land:** If you buy for .20 cents on the dollar, you might consider land, otherwise pass. This is always the last asset class to recover. Best bets: unfinished, infill subdivisions.

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