



December 29, 2009

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## Fear and Hoping in Commercial Real Estate

### *Industry Is Grateful 2009 Is Ending, But Worried It Won't*

Hope and fear are overlapping in the commercial real estate industry on this eve of a new decade. The industry doesn't know whether to look out for it or look forward to it.

On the one hand, the industry is grateful that 2009 is coming at long last to an end. It was by many accounts the worst year in its history as values and incomes shrunk at precipitous rates. Whether that comment can be backed up by statistics is debatable, but few would argue that the hurt was deep and widespread.

On the other hand, much of the bad from 2009 will carry over into 2010. Investors are saddled with troublesome debt and weak fundamentals and 2010 presents very few elixirs for the pains of 2009.

Go back in time one year and remember that the industry felt it was chronologically closer to the beginning of a recovery than the beginning of the downturn. The industry may seem a long way from those sentiments now. However, 2009 did give us surprises it never expected. REITs proved far more resilient than feared and even managed to raise abundant more capital and experience a mini bull market.

Still going into 2010, there is a sense the industry could mangle Franklin Roosevelt's famous quote: We have nothing to fear but fear itself. This year, the saying might go: We have nothing to fear but those things for which we hope.

"Most exciting about 2010? Unprecedented low priced buying opportunities," said Andrew Segal, president of Boxer Property in Houston. "Worries about 2010? Unprecedented low priced selling opportunities."

While that remark may come off sounding a bit contrived, it's not. We received many similar paralleled phrases in responses to our query of industry executives for this story.

"What most excites me [about 2010] is the prospect that commercial real estate may find its inflection point and start to turn upward in 2010," said Paul N. Arena, president of Venturi Capital Advisors Inc. in New York. "The last month of the year has brought greater optimism, and the investors with whom we have relationships are preparing to underwrite and invest in 2010. I'm further excited by a return to basics that we are witnessing—a move away from chasing vague or general opportunistic strategies, in favor of generous but realistic returns generated by specific, focused strategies that are; preferably, hard asset backed, and that can pay some form of current return."

Then Arena continued: "I am concerned that one, the commercial lending market will be slow to react to the increase in activity and to accommodate it, and two, that managers won't recall the restraint and lack of underwriting standards that got them in trouble in the first place."

And there in a nutshell is the irony that we are at a point in this recession where the dichotomy between hope and fear is so narrow that the two seem as one.

What follows are comments from industry executives and observers first about what excites them about 2010 and second what worries them about 2010.

#### What Most Excites Us About 2010

The prospects for 2010 are much brighter than we would have imagined even six months ago. Liquidity is returning to the market, as evidenced by the powerful resurgence of the public REITs, the ability of private

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REITs to raise capital from retail investors, increased lending activity by life companies and the successful execution of the market's first securitizations in more than 18 months.

Christopher T. Moyer, Associate, Cushman & Wakefield Sonnenblick-Goldman, New York, NY

Opportunities in the acquisition of REO as well as underperforming, nonperforming and distressed debt.  
Donald A. Shapiro, President / CEO, Foresite Realty Partners, L.L.C., Rosemont, IL

Here in the Metro Detroit area, I am hopeful that residential housing market has reached a bottom which will hopefully translate into increased consumer confidence. I am optimistic that values will slowly increase over the next years. Our firm is very diversified and opportunistic so I believe there will continue to be buying opportunities that are unprecedented. I believe some of the well capitalized discount retailers will be conservatively looking at taking advantage of discounted rental rates and pursuing infill sites. 2010 will be a year to look to purchase as more REO opportunities will surface.

Harry Cohn, Director of New Business Development, Broder & Sachse Real Estate Services Inc.,  
Birmingham, MI

I am cautiously optimistic about 2010 in that we could have a period of a stable bottom of the market place where deals trade at profitable cap rates for buyers - 9% to 12% - and that stays the new normal for the next few years. The downside of the new normal is that deals financed at 5% to 6% caps won't be able to refinance as the terms come due and there will continue to be defaults.

Stephen Karbelk, CAI, AARE, President/Broker, National Commercial Auctioneers, Tulsa, OK

I am most excited about the commercial real estate cycle bottoming out, which will probably occur about halfway through 2010. I think that the second half of the year will be when the smart money that has been sitting on the sidelines gets back in the game and these investors will be buying properties at historic lows once the cycle ticks back up. That will be good for brokers and investors.

W. Price Muir, Vice President, Raulet Property Partners Inc., Atlanta, GA

Perhaps, this year banks will be willing to sell assets at prices that make sense to buyers. Up until now the bid-ask delta has been too large for any velocity to make an impact on the marketplace.

George A. Arce, Jr., President & CEO, Centers Dynamic, Redwood Shores, CA

The potential for the banks, special servicers, and FDIC to make the process of buying their delinquent notes and foreclosed assets a reality in a more transparent, market-dictated-price process. We are excited about the fact that these bad debt holders might actually sell the notes/properties in 2010! We are excited about the potential to actually buy properties that make sense on today's terms and market fundamentals.

Steve McCrann, President, MB 35 LLC, Carrollton, TX

Transaction activity will be more prevalent than what took place in 2009 although transaction activity will begin at a slow pace through the first half of 2010.

Matt Tritschler, Senior Vice President, Colliers Investment Services Group, Atlanta, GA

What excites me the most in 2010 is that any day you can find that rare "home run." It doesn't happen every month or every year. It is the challenge to outwork everybody else and find that special property.

Steven Aberman, Senior Acquisition/ Leasing Manager, WBS Properties, Boca Raton FL

The ever-so-eagerly-talked-about possibility that 2010 brings a bleak and minute chance that not only will 2010 not be as bad as 2009, but that there may be blue skies appearing in the real estate world for 2010.

Matthew DePrato, Acquisition & Development Coordinator, PFG Capital LP, York, PA

Refinance opportunities for multifamily and health care facilities. We should start to see some conduit maturities toward the end of the year that will be seeking refinancing.

Ron Weis, Vice President, Gershman Mortgage, Springfield, MO

The opportunities that arise from this economic destruction that would not have been there otherwise. We

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are finally going "back to the basics" where accountability and performance are "King!"  
Leigh C. Bower, CFO/Partner, US & Company Real Estate Advisors, Atlanta, GA

I think and hope we will finally be past the negative attitudes of 2009, in real estate and in general. If we are, people and companies will be able to get back to "business as usual" which will be good for everyone's psyche and good for our economy.

Howard Greenberg, Principal, Howard Properties Ltd., White Plains, NY

The hope that corporate decision makers will begin to "get off the fence" and make decisions regarding the growth of their businesses. Also, the decrease in unemployment which will have a positive effect on corporate growth, thereby stimulating expansion and relocation.

Barbara Bennett, Vice President, Thompson Realty Corp., Dallas, TX

We have experienced one of the longest recessions and constraints on our financial system. Hopefully 2010 will be a year when we see a measure of economic recovery and the full impact of the stimulus funds.

Carl J. Conceller, Principal, Coldwell Banker Commercial CRA, St. Louis, MO

Distressed properties. They're with us for a while and will provide opportunity and work for real estate professionals.

Kostas Stoilas, Associate - Industrial, Cushman & Wakefield Inc., Tampa, FL

The much anticipated "bottom" of the commercial real estate sector. Hopefully this will encourage sidelined investors to get back into the game and take advantage of the situation.

Laura Di Bella, Adams Property Consultants Inc., Coral Springs, FL

What Most Worries Us About 2010

Official U.S. government policy of "pretend and extend" is going to exacerbate the problems in the commercial real estate market. What should have been a painful march towards normalization has not only been arrested, it's been partially derailed. Essentially, U.S. policy has taken what otherwise would have been a slow moving traffic jam, and turned it into a massive pileup.

Steven Sandler, CEO, Crosswind Capital LLC, Rye, NY

We are worried about market stagnation like in the first part of 2009. Some financial institutions are taking strong action to move forward with their inventory of loans and problem assets, but others are ignoring their problems and pretending they don't exist. I think banks are making a huge mistake in working-out too much of their loans rather than taking back the assets. Banks can mitigate losses by selling to people who know how to fix bad assets. A lot of what we see now is bad investors who have made bad decisions and are not being punished for their actions. These same individuals continue to invest while thinking that if they make mistakes it will ultimately fall back on the banks or their investors. This is bad situation. Real estate is not going to come-out of its slump any time soon. We have excess inventory on shopping centers and much less available dollars to spend in them. The general contraction of the economy will take a toll on all classes of real estate asset. For example, in multifamily products we have seen rents going down 15-25% in the Los Angeles core markets. Office occupancy is not going to improve in the next two years, and rents are being reduced.

Sagiv Rosano, Managing Partner & President, Rosano Partners, Los Angeles, CA

1) How much the high net worth segment of the market has not yet revealed the depth of its financial distress? 2) An over-recovered stock market. 3) A badly weakened US Dollar. 4) High natural resource and raw materials costs 5) The potential for future inflation and 6) That there has been too much money raised targeting high IRR equity returns that has already begun to overpay for the trickle of deals coming forth in an effort to do something, anything with the money, even if the realistic risk-adjusted returns don't justify the promises to investors.

Gabriel Silverstein, SIOR, President, Angelic Real Estate, New York, NY

Lack of liquidity on the debt side. The life companies have returned some liquidity to the market but CMBS and the banks are still a major question mark.

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William L. Jackson, Senior Vice President/ Managing Director, Northmarq Capital, Dallas, TX

That uncertainty will reign. Until an "RTC 2" is created with FDIC and REMIC enforcement of loan terms forcing foreclosures to clear the system, we will likely be in a long period of limited activity. Investors typically want either "safe bets" or "steals" in times of confusion. Everything else is priced to the most conservative underwriting and as a result, does not trade.

Bernard Haddigan, Senior Vice President & Managing Director, Marcus & Millichap, Atlanta, GA

Unemployment. This is the single most important gauge of recovery. While, nationally, the rate of job losses appears to be slowing-- and that's good-- we're still losing jobs as opposed to gaining on a net basis. And the fact that workers 60 and older may be postponing retirement and others may be accepting shorter work weeks may be masking the true extent of the unemployment problem. Until we start adding jobs at a significantly net rate, it's going to be rough going.

Fredric J. Leffel, President, Kaufman New Ventures. New York, NY

This market for investment sales in 2009 was brutal. Even when motivated owners priced aggressively to move properties, investors were hesitant to buy given horrible market supply/demand fundamentals and falling values. No one wanted to catch a falling knife. There are preliminary signs that the investment sales market may start moving again in 2010. It looks like increasing vacancy and negative absorption may be ending. There are lender owners willing to sell at cheap prices. A few distressed sales have set badly needed price benchmarks. And we are working with many clients who have real access to cash and are saying they are ready to buy. But, are these buyers really willing to step up in 2010? Has the fear of investing in an uncertain market shifted to greed to capitalize on the historic value opportunity?

Steven K. Lindley, Senior Vice President Capital Markets, Grubb & Ellis|BRE Commercial, Phoenix, AZ

I think the biggest fear for most of us is that all we are really doing is replacing a few digits; 2009 to 2010. Economic fundamentals don't change just because the calendar does.

Barry C. Smith, President, LoanSaleCorp.com, Scottsdale, AZ

What worries me most is that there has been a fundamental breakdown of the capitalist system and we won't be able to "re-boot" the system by the usual methods (government subsidies, loosening capital markets). I am concerned that the free market economy reached a critical mass in the 2004-2008 period and exposed an underlying core weakness or flaw in this system. Ours is a consumer based economy. Lack of savings, over extended credit, speculative investing, these are weak links in the capitalist chain. It worries me that we won't learn from our mistakes and adopt an attitude of systemic frugality and focused investment. It worries me that markets are dysfunctional at the core and the quick fix mentality just won't get the job done this time.

Rachel Maman, Acquisitions, Sales & Leasing, Hera Development Corp., Brighton, MA

I'm most worried by the massive amounts of maturing debt and the continued disconnect between buyers and sellers. The active investors today are focused on buying notes versus taking direct ownership in real estate. They get good upside without the "getting your hands dirty" element of owning real estate. The other thing that worries me is the bubble in the bond market. Junk bonds are now yielding as low as 7.5 %. Earlier this year these same bonds were trading at yields well above 10%. This can't continue.

Whitney E. Kerr, Jr., Principal/Vice President, Colliers Turley Martin Tucker, Kansas City, MO

Once again our wonderful politicians in DC do not understand that the "pork" has to be cut from the budgets. Yearly deficits will catch up with us all in the very near future. I'm very concerned that the bankers still have their heads buried in the sand and hope that we will not notice the huge bonuses being paid after a year of record setting profits. When will they open the lending for commercial properties? With \$1T in commercial loans coming due before the end of 2012 something has to happen, the sooner the better.

Jerry Hall, CCIM, Sperry Van Ness | Wilson Commercial Group, Columbus, OH

Looming loan maturities on commercial real estate concerns me greatly. TARP money with 3- or 5-year term does not adequately address the loan maturity issues. I hope our federal government will seek a

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long term solution versus short term solution. Complacency concerns me. In the last few days we have been reminded that we are not above another terrorist attack. We need to maintain our vigilance and never, ever forget 9/11.

Marshall De Wolfe, Senior Director, Mark One Capital, Palo Alto, CA

My biggest concern is that people may remain on the sidelines and not move forward. Businesses and consumers need each other to survive; and when either of them sits idle, they both struggle. There will always be reasons to sit still and do nothing. But those who are positioned to take advantage of opportunities-to grow, spend, hire, etc. and still don't because of the fear factor are delaying a recovery. Their reasons are understandable; however, we need to get the ball rolling.

Joan Earhart, Executive Vice President, Fullerton Community Bank, Fullerton, CA

Unemployment and the CMBS tsunami headed our way. We have started taking steps to address the CMBS "challenge" but I fear the timer is running down with no time outs left.

Kristin Hammond, Pacific Real Estate Partners Inc., Portland, OR

Unprecedented tenant concessions such as moving allowances, free rent, discounted rent, termination options, and turn-key tenant improvements. I anticipate these will get even more aggressive in 2010 and will force many Landlord's to sit on the sidelines because doing a lease deal simply won't pencil. Well capitalized landlords will have the advantage.

Matthew Hinrichs, Pacific Real Estate Partners Inc., Bellevue, WA

The nations growing debt. It has got to bite us in the near future. The banking industry is also still in for some hard times and the liquidity for commercial real estate shows little signs of improving. The banks are not showing or listing their inventory of homes because they would then have to write down the losses and increase their reserves.

Harry Bennetts, Olympia, WA

What really worries me about 2010 is that another bubble could burst. With government spending out of control, huge debt loads on companies and commercial properties, and high unemployment undermining consumer confidence, I expect there could be another event that triggers the marketplace to have another retraction. The retraction would most likely be short lived as a confidence disruption and buyers sit on the sidelines with deals put on hold. If the government raises taxes and pursues other social policies that undermine capital investment, prices will keep dropping since buyers will have to make more money to compensate for the higher costs of doing business.

Stephen Karbelk, CAI, AARE, President/Broker, National Commercial Auctioneers, Tulsa, OK

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