

# Insights

## Into Commercial Real Estate



**Are you wondering** what your landlord is thinking about the credit market debacle? This article recently appeared in the *National Real Estate Investor*, a trade publication that speaks to the owners of commercial real estate. We've added some highlights to the article and have provided a translation of those quotes below.

### Real-Estate Speak

### Plain Speak

"Declining real estate fundamentals will result in declining occupancy and rental rates, extended leasing times..."

= Landlords are hungry to lock up good tenants.

"...prudent lenders and borrowers are focusing heavily on asset management..."

= The value of a building is increased by high-credit, long-term leases. Both banks and landlords are putting a premium on such leases.

"The credit crisis could negatively impact a borrower's ability to refinance or sell an asset in a timely manner."

= Landlords are realizing that they may have trouble selling their buildings if they do not have high-credit, long-term leases in place.

"Even after the market bottoms out, it will take time to build liquidity back into the real estate finance market."

= The bottom of the market is near and the next up-swing may take time to develop. Now is the time to lock in long-term rates.

**Bottom Line** The bottom line is that landlords are getting nervous. The current concerns with the economy have caused many business to "pull in their horns", which means fewer tenants in the market. Your landlord may be very hungry and now might be a perfect time to renew your lease, even if it does not expire for years. Give Tenant Real Estate Advisors a call to discuss if now might be the right time to lock in a low lease rate for you. Call us.

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LAST WORD

## Trouble Lurks Under the Surface

Stay alert for crosscurrents in today's commercial real estate market. **By Russ Kappenman**

**T**he waters of the commercial property markets appear calm, but is more trouble lurking beneath the surface? Whether you are a lender or a borrower, the ongoing credit crisis is making us all think about the water in which we're swimming.

Today's environment leaves us asking, "Why does it feel so bad out there?" The answer is that with few exceptions, today's crosscurrents are being caused by the capital markets and not real estate fundamentals — at least not yet. **Declining real estate fundamentals will result in declining occupancy and rental rates, extended leasing times,** additional equity contributions and added delinquent loan activity.

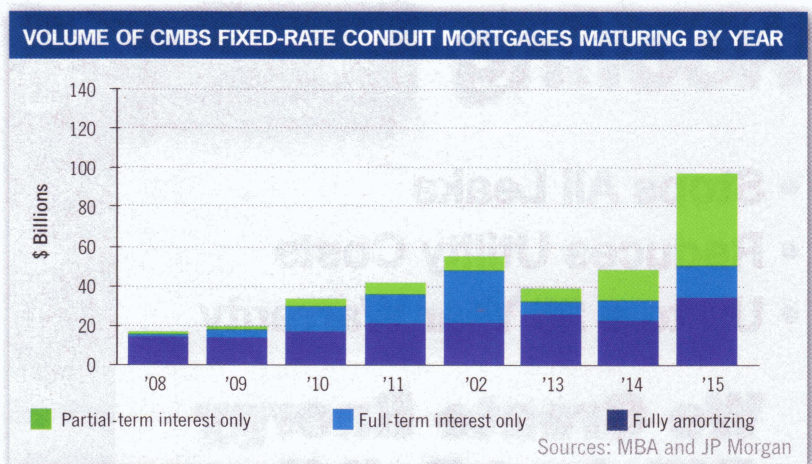
While most pundits have indicated that the dramatic drop-off in sales transactions isn't going to rebound until the market finds an equilibrium, the soft market leaves a bit of time to contemplate what happens if the capital markets crisis leaks into real estate fundamentals.

In fact, issues have already cropped up in the retail sector as several chains have announced closures and downsized business plans. Retailers such as Linens 'n Things, Steve & Barry's, and Mrs. Fields Cookies have all filed for Chapter 11.

Against that backdrop, **prudent lenders and borrowers are focusing heavily on asset management.** While commercial real estate default and delinquency statistics are still at low levels for most lenders, "watch lists" continue to grow as asset managers review their portfolios.

### Plan for the worst

Sound asset management always makes good business sense, but now is the time to double down on your efforts. Market players need to evaluate their holdings by asking themselves some key questions: How do market forces — including a slowing economy, rising unemployment, weakening consumer demand



and higher commodity prices — affect the revenues and expenses of your holdings? Does the answer vary by asset type or quality, or by market or submarket?

But that's not all. At what rental rate are leases being executed in your submarket, and how do they affect your asset? When will your next tenant improvement/leasing commission occur, or when does your balloon payment on a particular asset occur and how will it be funded? Can the asset be refinanced, or is it readily saleable in today's marketplace?

**The credit crisis could negatively impact a borrower's ability to refinance or sell an asset in a timely manner.** Such situations may become more prevalent as larger debt volumes approach maturity in a real estate finance market with limited functionality (see chart).

Borrowers will need to convince lenders they've devised a business plan that will allow their troubled asset to succeed. Borrowers should negotiate for longer-term solutions, thus negating the need to go back to the lender frequently. Renegotiations will cause the lender to lose confidence in the borrower.

### Capital providers' tough love

Lenders must understand the troubled asset and its borrower to determine an appropriate course of action. Lenders

will exercise more patience with cash-flowing assets than they will in situations where the cash flow has been impaired. Requiring debt repayment in a market that won't provide financing may not be the lender's best course of action. Lenders must determine how to recover their principal and should develop a strategy to resolve the default and clearly communicate it to the borrower.

While lenders will need to exercise some patience with cooperative borrowers, they must also be ready to act firmly in order to protect their interests. Lenders need to focus on the end goal and avoid reacting to singular events. No one wants to be surprised by a cash flow shortfall that may have been avoided. Our obligation as asset managers is to minimize those surprises.

While all industry participants are hopeful the credit crisis will soon hit bottom, nobody has a crystal ball. **Even after the market bottoms out, it will take time to build liquidity back into the real estate finance market.** Meanwhile, stay alert. ■

