# Market Perspective

## *The Frozen Tundra: Commercial Real Estate*

As buyers of office and industrial real estate, we've spent most of the last year chanting the same mantra, which is "stay patient." For us, this means wait for better opportunities, because the longer you wait, the more attractive the acquisitions will be.

Lately, we've grown weary of this mantra, and have wondered when the log jam that's stopping the flow of commercial real estate transactions will break. I was visiting recently with a successful multi-family developer that shared our same frustrations. Although we both have plenty of capital, neither of us is seeing attractive acquisition opportunities materialize. It's as if the industry is stuck in neutral. Here are some of the things that are contributing to this morass:

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» The anticipated flood of commercial foreclosures is not materializing. Banks are renegotiating and extending notes but have gone out of their way not to take back properties. Obviously, banks have already taken big losses on residential real estate, and we believe they have chosen to defer inevitable losses on their commercial portfolios because of the tremendous pressure to become, or appear to be profitable.

» The recently enacted Mark-to-Market provisions should serve to extend the lack of commercial foreclosures. This provision will allow banks to maintain book value on loans for a longer period, and not be forced to recognize loan losses until they are realized.

» Like in the stock market, real estate investors ask, "will it be cheaper in six months?" Therefore, have been hesitant to acquire new assets. In our industry, fear of making a mistake is at an all-time high. Put another way, confidence is scarce.

» Leasing fundamentals have deteriorated substantially since mid -year 2008, contributing to the lack of confidence referenced above.

» Despite the banking bailout, there is essentially no debt capital available for the majority of potential transactions. We estimate that approximately 20% of the commercial transaction volume done in 2006 and 2007 is being done today – and that's only for the bulletproof, well-leased, credit tenant or substantially diversified deals. Fortunately for our multi-family friends, Fannie and Freddie remain active lenders.

» CMBS transactions, once a huge segment of the financing market, have obviously vanished and have yet to come back in any measurable form.

» Equity, long rumored to be on the sidelines, is still around, but the amount of it is diminishing rapidly. There are significantly fewer buyers today than there were two years ago. Fewer buyers mean less bidders and lower prices, so most sellers are choosing to delay a sale until forced to do so.

» Low interest rates on existing loans have allowed all property owners to carry non-performing assets for longer periods of time. These lower interest rates reduce the interest carry burden and extend the life of reserves, allowing owners to hold on to non-performing assets longer.

» Long lead times in the commercial side of the real estate industry (in place leases, length of loan terms) serve to delay the onset of lower NOI or immediate refinance problems for some properties.

All of these things have contributed to the frozen tundra of transactions that we're all experiencing in commercial real estate. Despite plenty of pain being felt by our peers, very little is changing. The quagmire will end soon, but a lot has to happen before meaningful transaction volume returns to our industry.

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