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Bright Spots: SIORs Closing Smaller, User-Driven Deals with

Local Financing, Solid Credit, Government Help—and Cold Cash

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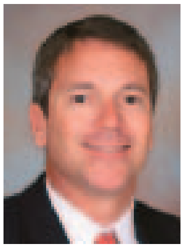
By Steve Bergsman

Anyone working in commercial real estate these days knows how difficult it is to find financing for the few potential transactions that surface out of the abyss. Even when there are willing buyers with long experience and good credit, most lenders still view potential dealmakers with trepidation.

That being said, a random survey of SIORs across North America, shows that all is not lost and a much smaller, but still steady, stream of deals are being completed. These are not big projects with global lenders and institutional developers, but downsized developments and smaller buildings where financing can be handled locally. For the most part, speculators have disappeared—some might say that's a good thing!—and the dealmaker of choice these days is a business that will be acquiring for its own use.

The financial playing field remains conservative, but the SIORs who were interviewed by *Professional Report* feel that things are a bit better at mid-year 2009 than any time over the past 12 months.

For example, in Charlotte, North Carolina, a fast-growing metro area beaten up recently due to the local economy's heavy reliance on the financial industry, one can turn to a host of lenders, from local banks to national companies with a presence in the city, all of which seem willing to continue lending to commercial real estate—with a key limitation. If you want to build, no deal; if you are an ongoing business looking at new space, this transaction will get financing.



"There's money for users; no spec financing," explains **Lawrence M. Shaw Jr., SIOR,** a Principal with Clarus Properties Inc. in Charlotte, North Carolina. "If you wanted to buy an industrial building for your company, there is money for that from such lenders as Wells Fargo, Bank of America, BB&T, and local banks."

In February, Shaw brokered a deal for a 33,000-square-foot building and got very favorable loan terms from a local bank: 85 percent loan-to-value, 20-year amortization, and a five-year call.

This was recourse debt. As Shaw notes, "This deal priced at $1.1 million. Deals need to be greater than $3 million to be considered for non-recourse."

Things are not much different in the middle of the country. St. Louis is "finally back to having the user drive our marketplace," observes **Christopher R. Fox, SIOR, CCIM,** a Principal and Managing Director with Gateway Commercial/Cushman & Wakefield Alliance in St. Louis. "For a period of time over the last three to four years, it seemed the securities industry was driving the real estate investment market, and most people lost sight of the users occupying those assets."

St. Louis is a good market for users seeking acquisitions to fulfill small- to medium-space needs because it counts about 70 local banks that are conservatively lending. "Equity requirements come in at 20 to 50 percent depending on the transaction, but our local banks are lending," says Fox. "The amount of equity needed from the purchaser rests on what you are buying, credit of the buyer, credit of the user or users, and whether it is single- or multi-occupancy."

In one example of such a user-driven deal, Fox's office, along with Cushman & Wakefield, is currently completing a transaction involving the sale of an older, corporately-owned project to a local developer who will in turn redevelop a portion of the project to house a company that is consolidating units from different facilities into one leasehold interest.

"A corporate entity owned an office building here that is currently occupied by a predecessor company they acquired under a leasehold interest," explains Fox. "That company consolidated and moved its employees from two locations into a new office project being developed by Duke Realty Corp. "We were able to sell the asset to a local developer who subsequently leased almost 70 percent of the building to another user."

Also in the center of the country, **John P. Stacy, SIOR,** a principal in J.P. Stacy & Co. in Leawood, Kansas, outside of Kansas City, Missouri, reports all types of transactions are down, but many of the deals getting done are from "good solid businesses that see an opportunity to buy some space cheaply."

These are user deals in which the buyer must be a "viable business with rock, solid credit," Stacy adds. "There is no money for average companies or investors."

Where would a rock solid business turn for financing in the Kansas City area? To local banks, Stacy says. "There are several banks in KC that can lend, as we have not been hurt like some cities dominated by money-center banks."

Real Money Gets Real Deals

There is one other type of deal getting done in Kansas City, Stacy adds, and that's with buyers who have the cash to complete a transaction quickly. With cash, any financial structure can be used for acquisition purposes.

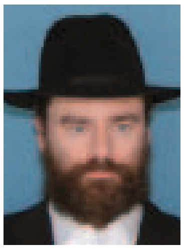
Stacy gives an example of a deal he recently worked where a client bought a loan from the Federal Deposit Insurance Corp. which was seriously discounting loans to get them off its books. "My client bought the note on an older, Class B office building for cash at a 50-percent discount. The building is 60-percent occupied."

Moving back to the East Coast, **Michael C. O'Brien III, SIOR,** like John Stacy, works at a company with his family name on it, M.C. O'Brien Inc. of Brooklyn, New York. And like Stacy, he says the deals getting done in his region were mostly with all cash and no institutional financing.

"We closed three deals this year, two were all-cash and the other was 70 percent in certified funds," says O'Brien. This doesn't mean the transactions were simple. In one deal, a user was buying a former auto service center. Since the sellers were getting a large amount of cash in the deal, they agreed to seller-finance the shortfall for the short term.

"In a lot of these deals, the seller holds the paper," explains O'Brien. "The buyer puts down 30 to 40 percent and the seller takes back the balance. The seller gets a better return acting as a lender, than putting an equivalent amount in a bank by holding a secured note."

Among the user-buyers in Brooklyn was O'Brien's own company. The firm, in celebration of its 100th anniversary, purchased a building for its own use.



Gabriel M. Silverstein, SIOR, President of Angelic Real Estate, works another big city market, Chicago, Illinois, in addition other major U.S. markets. The Windy City is obviously a high-rise, institutional real estate market but the deals getting done are with smaller properties. The problem for owners is that, in this economic crunch, there is no liquidity for big transactions, and that drives down pricing. Silverstein gives this example of a project he is working on. A building that was 70 percent occupied was acquired a few years back for $18 million. Today, the building is 100 percent occupied and worth less than on the day it was bought. Why? Because the loan on that building will turn over in a relatively short period of time, and the $64,000 question is, can that loan be refinanced? Who wants to take that chance?

Instead, the highest volume of deals getting done in Chicagoland and across the country in the markets Silverstein works, involve single-tenant, triple-net buys of $2 to $5 million, says Silverstein. "This is stuff like buildings for Walgreen's or Starbucks. These deals have good momentum because buyers use cash, and if they don't have cash, small banks will lend. Companies like Walgreen's sign 25-year leases and the developer will sell the building to whichever company will add it to a portfolio."

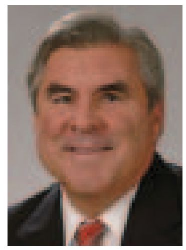
Things are completely different in another populous city, Jacksonville, Florida. "Deals that are getting financed outside of agency-eligible, multifamily are well-located, cash-flowing assets of all types," says **Lang C. Tarrant, SIOR, CCIM,** a Partner with Sterling Real Estate Capital. "You need at a minimum 1.25 plus debt service cover ratio and assumptions going forward need to include low to very little leverage."

The financing is getting done on the debt side by banks, some life companies, and private lenders, "but the lenders are being extremely cautious and underwriting has gotten very conservative. "There is just an overall fundamental change in the way banks and operating partners are underwriting their deals," says Tarrant.

Alternative Financing Opportunities

John R. Knight, SIOR, a principal in J.C. Rodman Co. in El Dorado Hills, outside of Sacramento, California, reports that as much as 90 percent of loans in his region are definitely user-oriented, but there are also a flurry of Small Business Administration loans to companies themselves, to be used for real estate where the buyer will occupy 51 percent of the targeted building.

Otherwise, the deals are all about equity, that is, how much the buyers have and how much they are willing to put into a transaction. One deal Knight is currently working is a property that is 50 percent occupied and for which the lender wants to do a five-year loan. The buyer will be putting 50 percent cash into the transaction.



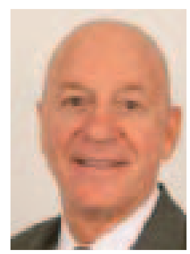
Over on the East Coast, **Martin J. "Chip" Ryan III, SIOR,** works at the Bethesda, Maryland office of NorthMarq Capital, an intermediary capital source that raisies equity for projects and transactions, including bridge loans and insurance-company financed deals.

As can be expected, the most financeable deals involve corporate users, where the companies have very good credit. However, being in the Washington, D.C., area gives NorthMarq Bethesda one advantage others don't have: The federal government remains active in the market.

"Gary McGlynn, a colleague, and I recently closed on a single-tenant deal where the tenant was the General Services Administration," says Ryan. "It occupied the entire building, but only had one-and-a-half years left on the lease. We restructured a loan that made sense to the lender, but because the lease was rolling over in the near future, we allowed for enough escrow for any potential lease commissions associated with potential vacancies."

Why would a buyer and lender be interested in a deal where the lease of the major tenant is rolling over? Quite simply, the federal government rarely vacates a building it occupies.

State and local—rather than the federal government—has been a boon to folks in Pennsylvania.



"In our state, we have the Pennsylvania Industrial Development Authority (PIDA), which is a quasi-governmental organization that provides real estate investment dollars for businesses that will create jobs. Those dollars fall in the second position behind the primary lender," explains **Philip Rothenberg, SIOR,** a broker with Jackson Cross Partners in Philadelphia. "In my city, the Philadelphia Industrial Development Corporation (PIDC) has a program that provides 45 percent financing in a second position, so that a borrower can go to a lender to get a 45 percent loan in the first position. The buyer has to come up with the 10 percent down."

Rothenberg recently did a deal in northeast Philadelphia where a regional sign company purchased a 31,000-square-foot, tilt-up industrial building. The deal looked like this: The buyer put in 10 percent, PNC Bank provided a 50 percent mortgage at 5 ¾ percent and the PIDC provided 40 percent of the capital in a second-position loan at three percent.

PIDC's involvement puts the first position lender in "a real sweet spot," only financing half the building, says Rothenberg.

Of course, there is always the old seller financing play.

"Right now if you are a speculative investor there is no money available, but you can do a deal if you can get the owner to finance the transaction," says **Keith K. Edwards, SIOR, CCIM,** a Vice President at the Caldwell Companies in Houston, Texas.

Edwards brokers vacant land, which is by definition a speculative investment. The kind of deals he has been doing has the buyer putting 25 to 30 percent down and the seller financing the rest over a 12- to 24-month period. Obviously, the expectations are that the buyer will be able to refinance in the near future. Edwards has done a number of these acquisitions and reports that he has three more under contract.

One caution on these kinds of deals: The land has to be owned free and clear.

In one transaction, Edwards has been working for a trucking company that is buying land with 30 percent down and is seller-financing the rest on a one-year, interest-only note with no prepayment penalty. The trucking company's objective is to get an SBA loan to make improvements and get the business up and running. An SBA loan takes time, but the deal at least allows the trucking company to take possession of the land.

Capital Available

Finally, on the good-news front, *Professional Report* checked in with **Douglas L. McMurray, SIOR,** Managing Director of Avison Young Commercial Real Estate in Vancouver, British Columbia, Canada.

"In Canada, our banks are a lot more solid. They didn't get into the problems the banks experienced in the United States," McMurray says. "They didn't have that exposure and as a result we have lenders that have funds allocated to lend. About four months ago, the spreads to borrowed money were about 300 to 400 basis points, but now you can find spreads as low as 280 basis points."

This is not a free flow of capital, McMurray adds. "New customers are having a difficult time getting money, but if you are an old customer of a bank, it will work with you."

Also, most deals in the Vancouver area are for smaller properties, in the $5 to $10 million range, and are done by local purchasers. "The sweet spot for local banks is up to $25 million; anything higher would be tougher," says McMurray.

For example, McMurray's office closed a deal recently where a McDonald's restaurant was sold for $3 million to a local buyer. The LTV was 65:35, and the lender was a local credit union (credit unions are very active lenders in the province of British Columbia).

Back in the United States, **Donald F. Murphy,** the CEO of Capital Asset Structuring of New Smyrna Beach, Florida, an SIOR General Associate member, wants to let the SIOR community know his company has capital to lend.

"We are consultants for a loan program that is internationally sourced and we have money to lend," says Murphy.

Is this an idle boast? No. Murphy reports that Capital Asset Structuring has been working on large requests such as the $300-million acquisition of a hotel/timeshare project in a "major southern city" and a LEED-certified project from an SIOR affiliated organization in Florida for $56 million.

"We look at every project on an individual basis," says Murphy, "and, frankly, everyone I talk to is favorably impressed with the loan terms—typically LIBOR plus three. And we have no application fee."

No excuses now, maybe it's time to step up to the plate with an offering from Capital Asset Structuring.