

From: [Lindsay Moore](#)
To: [Bradley Gillis](#); [Melissa Marcum](#)
Cc: [Brent Miller](#); [Amy Miller](#)
Subject: Article - Recessionary Strategic Planning for Commercial Real Estate Professionals
Date: Friday, June 12, 2009 11:19:48 AM
Attachments: [Brad Gillis \(CURRENT\).JPG](#)

Recessionary Strategic Planning for Commercial Real Estate Professionals

By **Bradley Gillis, CCIM—Senior Advisor Sperry Van Ness – Miller Commercial Real Estate Salisbury, MD**



As I speak with clients, co-workers, and industry pundits, the one thing we all agree upon is that the economy is bad, and that we haven't found the bottom yet...especially where commercial real estate is concerned. While opinions may vary as to exactly where the market is headed, and the timing surrounding any major shifts in direction, everyone reading this paper understands one thing; the markets are fluid, evolving, and ever changing. Therefore the conundrum that those in the practice of professional commercial real estate are faced with is how to best position their portfolio to minimize the risks associated with market uncertainty, while at the same time maximizing current and future returns.

In this month's piece I'm going to attempt to take guess-work of market prognostication out of the equation by not relying on a crystal ball approach. Rather I'll take a more granular journeyman's approach in providing advice on tactical direction based upon the actual data and events we know to be true...no hype, no rhetoric, just the facts.

What We Know

All of the recent financial data that has been released over the past several weeks has indicated that an economic recovery won't happen anytime soon. In a recent public speech, President Obama indicated that unemployment will continue to rise in the near term, and we all know that the trickle-down of rising unemployment does not bode well for commercial real estate. While most of the media attention has clearly been focused on the trouble in residential real estate markets, I feel the larger risk to the economy lies in

the risks associated with defaults on commercial assets.

According to data provided by REIS, defaults and delinquencies on hospitality, retail, and office properties have more than doubled in the last six months alone. Even more disconcerting is that default rates for industrial and multifamily properties have increased more than 80% during the same period. It doesn't take a rocket-scientist to understand that this sudden up-tick in late payments and defaults has many observers feeling that the next shoe to drop on the economy will be a collapse of the commercial real estate market.

While the risk is still difficult to quantify, we do know that it is highly probable it was underestimated in the FED's recent stress test of 19 major banks. The results of the stress test released just a few weeks ago, projected that should the recession worsen, the losses from commercial real estate loans could hit \$53 billion, or 8.5 percent of their overall loan losses over the next two years. We know that the government historically underestimates declines. This I believe is particularly true given that the stress test did not include the majority of the regional and local lenders, which hold a big chunk of the nation's \$3.5 trillion commercial property loans on their books and who remain particularly vulnerable to further economic declines.

So how bad is the commercial real estate market really? In the bullet points that follow, I'll state the facts and you can draw your own conclusions:

- Approximately \$1.3 trillion in loans on commercial properties will be coming due between now and 2013;
- More than \$270 billion in commercial property loans are expected to come due this year alone;
- According to Real Capital Analytics, nearly \$73 billion worth of commercial real estate loans are in some level of current financial distress;
- A recent report by Deutsche Bank estimates that at least half the all commercial loans and two-thirds of those packaged and resold as securities, will not qualify for refinancing when they mature.
- Fannie Mae recently stated that apartment building loans that were at least 90 days past due almost quadrupled between December and March to a rate of 0.34 percent. As a result, Fannie Mae's credit-related expenses for apartment loans jumped to \$542 million from \$59 million at the end of last year.
- The market has experienced unprecedented commercial failures in recent months including the failure of Circuit City, Linens 'N Things, and General Growth Properties filing the largest bankruptcy in US commercial real estate history.

In a nutshell, the problem can be summarized by understanding that there is perfect storm in play as a result of the confluence of the following 5 factors:

- 1.) A recession

- 2.) A severe decrease in flow of funds
- 3.) A substantial decrease in operating income
- 4.) Increased vacancies
- 5.) A substantial decrease in valuations

These current conditions combined with tough new underwriting standards and tight money supply has eviscerated the refinancing ability of commercial property owners. However refinancing is just one issue...perhaps a bigger issue is that many properties are just not trading at numbers that sellers can stomach.

While I could probably fill several pages with depressing economic data surrounding mounting trouble in the commercial real estate markets, I don't see the need to belabor the point as the undeniable reality is that commercial markets are in trouble, and rapidly worsening. While there is great speculation that the FED will extend/offer additional assistance to commercial lenders to help offset mounting losses incurred by lenders, my concern is one of "good money after bad." The bailouts, subsidies, and unprecedented government intervention haven't stabilized the residential markets or the recessed economy, so why would any rational person believe these types of actions will resolve similar issues in the commercial markets?

What You Can Do

Don't panic...plan. The reality is that markets cycle, and while boom isn't always followed by bust, boom is *always* followed by some type of market retraction. While many drank the Kool-Aid of over exuberance created by the frothy market conditions of prior years, markets simply cannot sustain uninterrupted advances in perpetuity, and it's a fool's gambit to fall prey to this type of irrational thinking.

Prudent real estate professionals manage and monitor the balance of risk and opportunity on a consistent basis. They don't allow themselves to be whip-sawed by market volatility, or other changes in economic/financial conditions. Whether or not you believe there is an eminent collapse of commercial markets looming in the shadows, you must admit that market conditions have fundamentally changed. Therefore you must adapt your operating practices accordingly if you hope to minimize the damage to your portfolio, your investors, and your company.

I would encourage everyone reading this article to consider the following 5 suggestions for managing your way through to brighter days:

1. **Seek sound advice and counsel:** Analysis paralysis is not your friend. Rather than attempt to travel in uncharted territory, seek out intelligent people who have successfully blazed the trail before you. No single person has all the answers, and rather than finding yourself stymied by a lack of resources and/or information, I suggest you surround yourself with sound counsel, seek their advice, and then trust your instincts.
2. **Identify your risks and opportunities:** Immediately take stock of where you have the most risk and where you have the most opportunity...contrary to

popular business theorists, they may not be one in the same. Evaluate portfolios and individual properties, asset classes, geographic markets, tenants, leases, lenders, investors, suppliers, and even staff. Assign your best talent to your biggest problems and your greatest opportunities.

3. Speed is your friend: Move fast...don't allow yourself to fall behind the curve of market conditions being relegated into a reactive position. Be proactive in your approach and drive changes via proactive leadership.

4. Negotiate, Negotiate, Negotiate: Realize that most of your stakeholders are feeling the same pain you are. This is the time to restructure leases, operating agreements, loan covenants, etc. Virtually anything is in play right now. Cut your deals from a position of strength, before you end-up negotiating against yourself from a position of weakness.

5. Know when to hold 'em, and know when to fold 'em: Once you've identified untenable risks, eliminate them immediately, and similarly, once you identify solid opportunities, exploit them immediately. Don't fear taking a loss if it protects the solvency of other assets or your enterprise as a whole. You can either stop the bleeding, or live to play another day, or count the days until you're just another casualty of the recession. The choice is yours...choose wisely.

My Biography

Bradley J. Gillis, CCIM serves as a Senior Advisor for Sperry Van Ness/Miller Commercial Real Estate, specializing in the sale and lease of medical/professional office, industrial and investment properties on the Eastern Shore of Maryland and Delaware. Starting his Commercial Real Estate career in 2004, Gillis has secured more than 50 transactions resulting in a career brokerage volume in excess of \$18 million.

Prior to joining Sperry Van Ness, Gillis served as a commercial realtor for Long and Foster Real Estate Inc., where he represented buyers and sellers of income producing properties, commercial land and in addition represented retail tenants.

Notable career highlights for Gillis include the sale of a Walgreen's site for \$2.5 million, Berlin/Salisbury Medical Suites for \$2.3 million, as well as the sale of the 15,000 unit Northwood Industrial Park Complex. Gillis also completed a 35,000 square foot World Gym transaction in Salisbury, Maryland.

Active in his community, Gillis currently serves on the Board of Directors for the Salisbury Area Chamber of Commerce and Maryland Manufacturing Services. Bradley is also the chairman for both the Traffic and Safety Advisory committee for the City of Salisbury and the Delmarva Chapter Committee of CCIM; Gillis is a member of the Salisbury Wicomico Economic Development and Ocean City Chamber of Commerce. In addition to promote proactive broker cooperation Gillis host Sperry Van Ness's Annual Broker Forum on the Eastern Shore of Maryland.

Gillis was recognized by the Coastal Association of Realtors as a "Young Gun" in 2007. He is licensed in both Maryland and Delaware, and holds the industry's most prestigious designation, Certified Commercial Investment Member (CCIM). Bradley is also a graduate of Shore Leadership.

Gillis earned a bachelor's degree in Business Administration from Hawaii Pacific University in Honolulu, Hawaii and is currently living in downtown Salisbury, Maryland.

For more information you can reach Bradley at any of the contact points listed below: Email: Bradley.Gillis@svn.com Phone: 410.543.2440 Web: www.svnmiller.com

Copyright © 2009–Bradley Gillis

This Office Independently Owned and Operated

All information presented by Sperry Van Ness has been obtained from sources deemed reliable. Sperry Van Ness makes no representation with regard to the accuracy of the information contained herein.