

Debt Markets

December 4, 2009

An important component of real estate investment is debt. Real estate investments, due to their capital-intensive nature and the structure of leasing markets, rely on debt for their historically high returns. If debt is not available, the price of real estate will fall dramatically. So, in a very real sense debt is important to us as investors going forward. At the same time, it is the restriction of debt that contributes to opportunistic buys. We look for balance. There will be buying opportunities because there are owners who are capital starved and over leveraged even in "normal" conditions. However, we are also interested in the presence of disciplined debt sources.

Yesterday's Wall Street Journal contained two interesting articles. One about Collateralized Mortgage Backed Securities "CMBS" indicated that the market is forgiving past sins by supporting a CMBS issuance at 75% loan to value and not backed by TALF, the federal government's lending program to purchasers of Commercial Mortgage Backed Securities. It is also important to note that this latest issue by Inland Western Retail Real Estate Trust is a single-borrower issuance. Most CMBS issues are multi-borrower pools. That may not be so significant as it is solely the real estate that backs the bonds, but it is worth noting in the re-emergence of this major source of real estate financing. The re-emergence and evolution of the CMBS markets is a significant trend that we will watch with great interest as it will undoubtedly influence the value of real estate and a recovery of capital markets (transactions).

An unrelated event, but equally significant has come to our attention today. A large regional bank has told their customers that they have stopped all real estate lending. The bank examiners have ordered them to reduce their commercial real estate "CRE" concentration in their portfolio by \$7B. The bank will be moving to sell debt from the portfolio.

There are hundreds and hundreds of banks in the same position—too much CRE in the loan portfolio. This move by the feds is emblematic of how banks will be forced to reckon with their balance sheet issues and force properties (loans) onto the market.

Also in yesterday's Journal is an article on a building in Manhattan that will be auctioned in January. It appears as though SL Green, a major landlord in Manhattan and holder of mezzanine debt on the property, will be the successful bidder. The million square foot property is 40% vacant. The failing property owner is apparently a controversial sort and the property may have developed a stigma. "There were always issues with them and that building. It was difficult to get any deal done. I think tenants were nervous that the ownership wasn't very responsive," said Robert Sammons of Colliers ABR. This is representative of the fact that unresponsive and undercapitalized ownership can drive up building vacancy.

If bad ownership can spoil a property's productivity, good management can turn it around. About SL Green's pending control of the property a local real estate broker said, "They can manage properly and are responsive to the needs of tenants in the marketplace and the brokerage community." Yes, ownership must be responsive to its prospects and customers. Isn't that true for all businesses?

We are a firm believer that how a landlord conducts business is as important as the quality of the property. We have made several leases in Northwoods, the Columbus property, during a period of economic decline. Being responsive and creative with prospects is a foundation to successful leasing.

Please call us with any questions you may have. Thank you.