

Is Your Commercial Property Under Water? Get It Back On Track!

by Daniel A. Myers, Esq. for REDNews



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You have devoted five years of your life to developing a commercial property. You have researched the local market, selected a site, obtained financing, contributed hard-earned equity, received approvals and supervised construction. Now, the property is filling up at 4% per month and you are just waiting to sell it for a tidy profit, right? Wrong. Instead of owning a valuable income-producing property, you own an albatross. In this severe economic downturn, your commercial property is not only not filling up - it's not even covering the expenses and monthly debt service. It might not even be covering the expenses.

And, you are covering the shortfall month after month!

What do you do?

The first thing you do is take a deep breath and relax. Your commercial property is clearly under-performing, but there are a number of strategic options available to restructure your loan and turn your "albatross property" into a valuable, long-term investment. In fact, due to the unprecedented real estate downturn, now may be one of the most opportune moments to restructure your loan.

Step 1 – Collect Accurate Data

The first step in performing a loan restructuring is for the borrower to collect accurate data on both the under-performing property and the loan for which it serves as collateral. The borrower should make a copy of all loan documents. He/she should also collect information on the property's size, location and amenities, up to 3 years (monthly and quarterly) of income and actual expenses, occupancy and pricing data and a current rent roll. The property-specific information should be accompanied by as much market data as possible including competitor performance and demographic information. The borrower should collect any appraisals and photos and provide all of the information to the borrower's representative.

Step 2 – Analysis

The representative will then perform a proper legal and financial review of the borrower, borrower principals and the property. An experienced attorney should analyze the borrower legal entity and review the

loan documents including specific provisions dealing with recourse, events of default, guarantees, lender remedies and other provisions. The representative should also review the tax implications of the loan restructuring. Borrowers often think that a recourse loan leaves them with few options other than covering the financial shortfall. This is certainly not the case. All loans – whether recourse or not - can be restructured and a favorable outcome often depends more on the manner in which the borrower approaches the lender as opposed to the specifics of the loan in question.

The borrower representative also needs to do a thorough analysis of the property. This includes analyzing the property's current and historical financial performance and preparing a stabilized appraised value based on the property-specific information and the wider market data. The borrower representative will incorporate this analysis into the proposal for the lender.

Step 3 – Develop a Proposal

Upon review of the legal and financial information, the borrower representative will develop a comprehensive restructuring proposal for the lender. The ultimate proposal needs to be tailored to the borrower's financial strength, tax implications and an assessment of the property's future performance. The proposal may include one or more of the following components:

Modify the Principal. The principal loan amount can be reduced to a level that is consistent with the income produced by the property in the short or medium term. The reduction in the face amount of the loan is sometimes accompanied by a partial equity contribution from the borrower and may involve the use of a subordinate note ("B Note") that accrues interest and is payable upon sale of the property.

Reduce Interest Rate. The interest rate can be reduced to a level that produces a monthly debt service consistent with the property's current performance. The reduction of the interest rate can be of intermediate duration or extend through the end of the loan term.

Amortization Adjustment. The loan can be adjusted from amortizing to interest-only. In some circumstances, the borrower may deliver less than the current monthly interest and the shortfall will be added to the outstanding principal balance.

Term Extension. The loan maturity can be adjusted in those cases in which the loan has come due and the borrower cannot refinance at acceptable market rates.

REO Assisted Sale. The borrower can assist the lender in selling the property for less than the outstanding indebtedness and the shortfall will be either partially or fully written off.

Deed in Lieu of Foreclosure. The borrower can turn the property over to the lender. This approach is appropriate depending on the type of loan in question and the amount of the borrower's negative equity.

Step 4 – Reach Out to Your Lender

The well organized borrower with a specific proposal has a much greater chance of successfully restructuring a troubled loan. The borrower should develop and convey the proposal through an experienced legal or financial representative. This representative is familiar with many aspects of the workout process that can benefit the borrower. His presence also projects a sense of seriousness to the lender. The borrower may also want to consider contacting a local, experienced broker for an opinion of value. Lenders, like everyone else, prefer to be kept informed of on-going developments, especially when it comes to non-performing loans. Invariably, lenders respond more positively to borrowers that "keep them in the loop".

Step 5 – Get Started

Each loan restructuring is different and the outcome necessarily depends on the ultimate interests of the borrower and lender. The borrower's financial position and tax implications are important as are prospects for future improvements of the property.

You should keep in mind that, generally speaking, lenders are not in the property management business. Like the rest of us, they also have a distaste for expensive and unpredictable litigation. If at all possible, lenders prefer to help their good faith borrowers even if that means they take a "haircut" in the process. A borrower who approaches a lender in good faith can often resolve a troubled loan on favorable terms. The key is to be pro-active and offer the lender a well-thought out proposal that is acceptable to all parties involved.



Houston Office Market: Is This The Right Time To Evaluate Your Office Space Or Renegotiate Your Lease?

by Jason Whittington, Principal NAI Houston, for REDNews



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Given the state of the local and national economy and the continued loss of jobs, is now the time to be in the market evaluating your office space or renegotiating your lease? We think it is for a number of reasons.

The Office Market is in a transition from a landlord market to a tenant market. From 2006 through 2008, demand for office space was very strong, and Houston saw the most significant increase we had experienced in the Office Market in almost 20 years. Class A rental rates increased approximately 35% from early 2005 to 2nd Quarter 2009.

That trend changed in 2009, and now with businesses cutting jobs in this weaker economic environment, occupancy of office space is dropping and is likely to continue to contract over the next several quarters. Absorption of office space was negative 660,352 square feet in 3rd Quarter 2009, bringing negative absorption for the year-to-date to approximately 1.7 million square feet of direct space. The overall vacancy rate (including sublease space) rose to approximately 14.9% in 3rd Quarter 2009, compared to 10.3% a year ago. Direct vacancy rate for the same period is 11.8% compared to 8.9% a year ago. It is expected that the overall vacancy rate (including sublet space) will

continue to increase and could approach over 16% in 2010.

Asking rental rates are also on the decline, with the average rate in all classes decreasing 9% from the 2nd to 3rd Quarter, 2009 or \$23.03 per square foot. Effective rents (which take into account concessions) have seen a downward trend by as much as 10-15% in most submarkets. With demand weak, we expect vacancy to rise and rents to continue to decrease through 2010.

So, other than declining rental rates and increased vacancy, what makes this a good time to evaluate your office space?

Space Needs: With the loss of jobs and change in economy, many firms' office space needs have changed or decreased. We advise getting out in the market well in advance of your lease expiration and, with your broker's assistance, conducting a space analysis of your office space needs. (Many architects call this programming.) Occupancy costs can be lowered substantially by more efficient space utilization. The trend in inefficiency of office space is evidenced by the increased amount of sublease space that has hit the market. In the 3rd Quarter alone, over 538,000 square feet of sublease space was added, bringing a total available to over 4 million square feet.

Existing Location/Lease: If you are considering staying in your current office space or building, now could be the right time to renegotiate your lease. Not only is it an opportunity to restructure your rental rate to current

market conditions by "blending and extending," but it may also provide the opportunity to redesign your office and "give back" unneeded space with out having to put it on the market for sublease.

Houston is not overbuilt; however, many landlords have commercial loans coming due over the next two years. These loans are one factor why a landlord will consider restructuring your lease early. By extending your lease, landlords are able to not only increase the value and possible sales attractiveness of their buildings, but it also helps them with the probability of refinancing existing loans. This "win-win" concept is another reason to look at evaluating or renegotiating your existing lease.

Upgrading Your Location: If you are considering upgrading your office to a more desirable building or submarket, then this is a good time to do it. This process can take up to 12-18 months, depending on amount and type of space. It is important to be able to "shop" the market and leverage one option against the other to make sure your existing landlord and other landlords are providing you the best economics and lease terms available.

Outlook: With a likely continued decline in overall market conditions over the next several quarters, and the shift being more toward a tenant's market, now is the time to be proactive with your tenant representation broker in looking at attractive long-term economics for your office space.

