



Distressed properties? What about distressed owners?

With all the news about the coming depression in commercial properties, it's not just buildings but owners and investors who seem to be really distressed. Some should be; others maybe not. Many properties are performing well enough but all the gloom and doom in the industry has upped the stress count. Where are commercial real estate values going? How many tenants will I lose? How much should I give in rent reductions? And so on. From our perspective as consultants, there are a few key items to assess before taking any drastic actions.

Rent

Tenants have been in to see you or your property manager about a rent reduction. How to handle this? Ask for two years of financials to see if there is a hardship and if you want to help the tenant. You may want some tenants to leave but for the keepers you can come up with a creative list on how to help them: rent reduction; CAM reduction; better advertising; retaining consultants to re-merchandise. Sometimes, with smaller mom and pop stores, it takes re-thinking strategy to increase sales if the tenant has the right merchandise, the right price and the right customers. Strong markets mask a lot of these problems but weak ones really expose them.

Vacancies

The kiss of death for a retail center is increasing vacancy. As centers start losing tenants, shoppers begin wondering what is wrong with the center. Some advise that you should keep tenants at all costs in this economy. But you need to consider the costs of finding and attracting new tenants. With rents on the slide and tenants asking for lower rents and more tenant improvements, the cost-benefit ratio of finding new ones will be slim. Carefully consider tenant demands and weigh this against tenant flight to other centers. Normally, tenants do not want to leave a successful center. But, on the other hand you have to consider what you do for one tenant will have repercussions on the others.

Location, building and site

Your center may serve an area on the downslide. It may be negatively affected by street and highway changes. You may have problems in your centers that you have never addressed: vehicle circulation, pedestrian flow, signage, branding, and a host of other factors. You need to consider what kind of fix would do the most good. Fixing problems now can dramatically improve your results and show tenants good faith that you are going to fix these problems.

In our experience some of these problems can be fixed at a nominal cost and produce dramatic results.

Financing

What is the situation with your lenders? Loans that are coming due in 2009 and 2010 are the main concern because the re-finance market is in shambles. The CMBS markets are dead. Insurance companies are overwhelmed. Large banks are not lending. So where do you turn? Some owners are selling assets to raise cash to de-leverage their portfolios. Cap rates of 10 are being offered on grocery-anchored shopping centers and sellers are having some luck selling them. But, do you need to sell? What are the penalties for not refinancing these loans? Maybe it is cheaper to pay the penalties and keep the loans until the lending markets turnaround. Or, maybe you are the pessimist and think the markets are going to get worse and want to bail now. This offers some great buying opportunities for cash rich investors to cherry pick these deals. What about Wall Street? Can you issue a secondary offering to raise cash and not sell the crown jewels? You need to talk to Investment Bankers to figure out the right course for your situation. There are no easy fixes here.

Being proactive

This is the time for your property managers to be visible and see the tenants on a regular basis. They need positive reinforcement. You can pick up ideas from one tenant and pass this off to other tenants.

Ultimately, the question to answer is whether it's the economy or your shopping center. It was clear, even before the recent crash, that many shopping centers, large and small, were obsolete. The changes in retail in the coming 10 years will be as significant as those that accompanied the coming of the shopping center two generations ago. There will be many more in the years to come.

Management should consider a top to bottom review of the properties from all these aspects. Financials are only one dimension to this. Managers and owners need to distinguish distressed from distressing properties. Consultants are often better equipped to do this review because they are more thorough in their analysis and do not ignore the sacred cows. In our work we have found that most organizations look at too few aspects and never consider the entirety of their properties and portfolio. These problems will not just go away. Now is the time to act and act forcefully.