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**Asset Overhang a Place for Opportunity**

By *Natalie Dolce*

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**Experts panel**

for opportunity.

CENTURY CITY, CA-It is no surprise to hear that activity remains pretty much muted industry-wide. And even though sales of distressed properties—which are expected to be the catalyst to re-energize investment—have yet to really materialize in earnest, experts at Thursday morning's "Meet the Experts" panel discussion were insistent on finding areas

David Rifkind, a partner at George Smith Partners, served as moderator of the intimate discussion, which drew roughly 60 top executives to the Hyatt Regency Century Plaza hotel here in Century. He found that there are opportunities; it is just a matter of finding them. "Hopefully going forward, we will be successful in addressing the asset overhang," he said, "and that is really where the opportunities should be."



**Experts panel**

Rifkind was joined by panelists including: Sean Crosby, a senior vice president at CB Richard Ellis Inc.'s retail valuation group; Adam Salis, a partner at Manatt, Phelps & Phillips LLP; Peter Roth, a partner at Allen Matkins Leck Gamble Mallory & Natsis LLP; and Matthew May, president of Sherman Oaks, CA-based May Realty Advisors.

**Trickle or Torrent?**

Rifkind began the discussion noting that there appear to be two distinct camps currently forming: Those that believe we are on the cusp of a huge commercial real estate liquidation, and those who say that the market will work itself out and that the numbers of distressed assets actually trading hands will be modest. He asked panelists, given what we know today, whether we will see a trickle or torrent.

The properties that are coming to market in the retail sector seem to be the ones that should come to market, explained May. "They are the ones that were overbuilt," he said, adding that he is seeing banks and CMBS lenders hold onto the properties, trying to figure out how to extend them before taking a hit on the books.

"There is going to be a torrent available, but it just isn't clear at this time if it is moving," said Crosby. "In the retail sector, more and more listings are popping up each day, but many of the assets put up to market sometimes get little response to them, or the seller takes them back off the market."

On the commercial side, there is little velocity in Southern California, says Roth, noting that there have only been a couple of trades this entire year north of \$25 million. "What will cause an uptick in

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velocity depends on whether or not a property is cash-flowing," he said. "If you are not cash-flowing, the real question for ownership is why would I come up with the funds and where would I spend the funds if I don't have any equity stake at all. It really depends on how long people can survive, what is their maturity date." Roth predicted that the next six months will be "spotty and modest."

A lot of banks are staying on the sidelines, especially those that can't take the capital hit, explained Salis. "Getting to a reality will help to accelerate a little more transaction volume on the debt side. One of the biggest problems is that valuation has been at a freefall for sometime, so as they start to stabilize, and as people get their hands on what they are actually worth, it will be easier to get these assets off the books. There will be a lot of looking under rocks."

#### **Where are Cap Rates?**

It is fair to say that the market has been going through a phase of repricing for the past year or more, making valuation difficult. But where are cap rates and should they still be considered a primary way to value, asked Rifkind.

Both Crosby and Roth agreed that the cap rate should definitely be looked at, but it needs to be cross checked as there are many other factors such as cash flow, property, asset class etc. "The valuation analysis is not done by a cap rate at all," said Roth. "I don't think the cap rate is the driver anymore. There can be huge differences right now depending on so many other factors... Every property has to be looked at individually because they all have a story to tell."

#### **Wall of Maturity**

Unique to this cycle is the "Wall of Maturity," upward of \$100 billion of CMBS debt maturing between now and 2012, so how is the playbook going to be written, asked Rifkind.

Once a loan is in default, the rules that govern CMBS give the servicers a lot more flexibility in what they can do, said Salis. "Up until now, a lot of borrowers have taken the position that they need to go into default, but the new rules will allow the master servicers to do some limited types of modifications." He adds that part of what you have to do is "come up with a workout plan that makes the most sense for both parties and yields a better net present value than liquidation."

No servicer wants to take a loss, said Roth. "They are all about deferring the loss." And what that does, he explained, is open the door for discussion and get a dialogue going, because "if they can push it out and not have to realize losses, they will play kick the can a little longer."

#### **Flipping the Switch**

According to a recent analysis, retail property sales in the US are said to be down \$71 billion in 2009. Commercial real estate transactions are at the lowest level in decades, so what will it take to flip the transaction switch on? Roth noted that there is currently a lack of valuation clarity. "There is a lot of hearsay, but there aren't enough trades for there to be established a real sense of valuation," he explained. "Nobody wants to be the guy who buys in thinking it's at the bottom."

And appraisers can't peg it, Roth continued. "They generally look backward at trades that have actually happened and there aren't enough trades. We need enough trades so that an actual pattern of valuation can be established. Every property that is being sold now has a story because everyone knows it is the wrong time to sell, so you are only going to sell if you are absolutely forced to."

As for opportunity, when Rifkind asked panelists if they had \$3 million cash to invest in real estate in 2010, what they would be looking at, most responded that they would look for small, quality assets. May said that he would buy good core real estate on the west side...small retail that has long-term potential. "I am seeing a flight to quality," he said.

Salis said that a lot of the volume that you are seeing right now is on the residential side, such as the 10- to 25-unit multifamily projects in infill locations such as Anaheim or Santa Ana, so that is a place he would look.

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Roth would also look for quality. "The nice thing about quality properties is that there will always be tenants who want to park themselves there at some rate. You can't lower the rate low enough to chase tenants."

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