

# REAL ESTATE SPECIAL REPORT

SOUTH FLORIDA BUSINESS JOURNAL | NOVEMBER 21-27, 2008

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## FINANCE HUNTERS



Met 2 in Miami recently secured a \$250 million construction loan, but MDM Development Group and partner MetLife paved the way by investing \$250 million. Flanking MDM's Tim Weller are lender Kim Abreu of Bank of America and Gary Fitzgerald of Wachovia.

### Widespread economic crisis puts extra pressure on commercial real estate

BY DARCEE LUNSFORD

Loan defaults, distress sales and foreclosures of office, retail and warehouse properties in South Florida could be the next economic shoe to drop, according to real estate experts. Whether this sector hits the wall with a thud or a scrape depends on whom you ask. But, the binge buying, overpaying and loose underwriting of the real estate boom is poised to leave many property owners owing more than their buildings and land are worth in today's declining market.

Negative equity, paired with frozen financial markets and maturing short-term loans, is creating the potential for a commercial bust, some experts say.

"There is no replacement financing anywhere in America," said Angelo Bianco, senior VP of Crocker Partners in Boca Raton. "If you have a loan coming due in the next 12 months, you have a problem."

Many of the most aggressive, highest leverage loans were written between 2004 and 2006 with lenient terms, including high loan-to-value leverage and interest-only payments. Loan terms ranged from five to 10 years.

The sum of all maturing commercial mortgages are expected to jump from about \$40 billion this year to \$70 billion next year and peak at \$90 billion 2010, according to data from AEW Capital Management, a Boston-based real estate investment and management firm.

#### FALLING VALUES

Bianco and other market watchers estimated commercial values have fallen 15 percent to 20 percent, putting many landlords upside down in buildings. If they have maturing loans, this could force them to come up with cash to cover lost value, default when balloon payments come due, sell for less than is owed or face foreclosure.

These are the distress scenarios Crocker and other opportunistic buyers with cash on the sidelines are waiting for. Crocker has raised about \$250 million to buy when the financing house of cards collapses.

The tough, new reality has the phone ringing in the office of Stephen Wechsler, VP of the finance group at Colliers Abod Wood-Pay. The Coral Gables-based firm recently launched a Distressed Property Services Group to handle financial workouts, recapitalization, foreclosure dispositions and management of distressed assets.

"Forty percent of the lending market was Wall Street - and they're gone," Wechsler said.

By most accounts, the failure of investment banks such as Lehman Bros., the evaporation of commercial mortgage-backed securities and risk avoidance by conventional lenders has largely smothered liquidity for refinancing, acquisition and development. The lenders that remain, Wechsler said, are life insurers and community banks. But, each offers limitations.

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## Commercial foreclosures and distressed sales are bubbling up

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Life insurers are conservative, he said, requiring as much as 35 percent equity in a deal. Interest rates can also top 8 percent. Community banks lend smaller sums under the right conditions. In September, Wechsler brokered a \$7.5 million loan to refinance the 123-room Best Western on the Bay Inn & Marina in North Bay Village. Coconut Grove Bank was willing to lend on the property, but the borrower had 60 percent equity in the hotel.

Putting equity in a deal appears to be one way to get lenders, even conventional ones, to loosen up the purse strings.

Despite the credit crunch, Metropolitan Miami secured a \$250 million construction loan last month for its 750,000-square-foot Met 2 Financial Center.

The participating lenders include Bank of America, Wachovia Bank, HSBC Bank USA, RBC Bank and Bank of Scotland PLC.

The project is a partnership between MDM Development Group and MetLife. The partnership invested \$250 million of their own capital to build 25 stories before the construction loan was finalized.

"We wanted to get the project started as soon as possible," MDM VP Tim Weller said. The 50-percent equity stake, as well as solid preleasing, helped cinch the loan, he said.

But, some say the worst of the storm is still raging offshore.

### SEVERE SLUMP IN 2009

Coral Gables-based investment fund manager Blumberg Capital Partners is forecasting



The East Coast Fisheries restaurant on the Miami River is among foreclosed properties.

a "severe 2009 commercial real estate slump," with prices dropping as much as 20 percent.

"A byproduct of the price and economic downturns will be unprecedented buying opportunity, but we probably won't see a bottom in the commercial real estate sector before mid-2009 or 2010," CEO Philip Blumberg said. "We've yet to see all of the outstanding commercial property debt hit the market. So, come 2009, the bailout package is ultimately going to have to be larger to adequately cover commercial property loans, or we're going to face an even more severe economic slump, hurting occupancy rates and accelerating the impact on the sector."

Commercial foreclosure and distressed sales are already starting to bubble up in South Florida.

Among the more high-profile sales is the former East Coast Fisheries restaurant on the Miami River. A California-based group that includes Earvin "Magic" Johnson foreclosed on the property's \$15 million loan and have relisted the restaurant site for sale. The site was suppose to become a 32-story condo and retail tower and marina, but the developer was unable to get a construction loan.

Alex Zylbergait, associate VP at Marcus & Millichap, has several distress listings, including a 30,000-square-foot medical office

building in Pompano Beach where the lender may be willing to take less than is owed.

But, he doesn't think problems will become systemic or even rise to the level of the early 1990s, when many commercial properties wound up in the Resolution Trust Corp.

"There is some level of distress, but it is not widespread," Zylbergait said.

The University of Florida's third-quarter Survey of Emerging Market Conditions also paints a not-so-dismal picture of commercial real estate sentiment.

The in-depth polling of 392 real estate developers, brokers, investors and analysts state-wide found that operating conditions in industrial and apartment markets are expected to remain stable. Respondents, however, predict weakness in office and retail markets.

"Short term, I think, everyone does expect a bad time," said Wayne Archer, executive director of UF's Bergstrom Center for Real Estate Studies. "If the markets don't get liquid again, then that is going to be a problem."

In the meantime, developers like Philip Procacci of Procacci Development, which has construction loans coming due in 2009 on the 140,000-square-foot Emerald View at Vista Center in suburban West Palm Beach, are seeking extensions and focusing on leasing, which bolsters the value of his properties.

"My strategy is to secure good tenants and wait out the markets," he said. "I think it is going to be a tough year as construction and permanent financing comes due. The market is just not there."

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