Real Estate

Ron Kleinberg

All Quiet on the Eastern Front

Four months ago I went out on a limb (maybe it was a twig) when I predicted Long Island was teetering on the last legs of a sellers' market. Specializing in the brokerage of investment properties with my partner Dale Staudigel, it wasn't hard to read the writing on the wall that said, "For Rent" on vacant storefronts and office suites island wide. The print in Newsday was black and white. Citing the economic meltdown, Circuit City, Fortunoff, Linens & Things, and Eckerds all filed for bankruptcy. National Wholesale Liquidators itself was in danger of being liquidated. Supposedly solid retailers were swimming in a sea of debt. Tenants were sitting ducks; calm on the surface but underneath paddling to stay afloat.

The misery on Main Street was compounded by a stricture of liquidity in the credit markets. Happy go lucky financial institutions that once injected the veins of investors with leverage were seizing up. The umbilical cord between borrower and lender was fraying.

On Wall Street the Dow wasn't fraying but unraveling. The bears had the bulls by the horns. Cash positions were quickly turning into fetal positions. Losses on the big board were easy to quantify if one had the testicular fortitude to open monthly financial statements. The economic news piling up in the fourth quarter of '08 was so grim, one felt less like a viewer and more like an eyewitness.

Today in the investment arena, the buzz is off the phones. Sales velocity has slowed. The ship has sailed. Reluctant sellers can only wave goodbye to the unrealistic and unsustainable prices that got away. Mispriced assets have lost traction and bidding wars merely skirmishes.

Well allocated owners that make up the core of our buying database are being distracted from the negotiating table, preoccupied with shoring up their assets (filling vacancies, pruning expenses, tenant retention etc.). Starry-eyed first time buyers have pumped the brakes as well. Suffering from depressed stocks and crumbling home equity (negative wealth effect), the neophyte buyer's confidence, like James Bond's drink, has been shaken not stirred.

While some sellers are still in denial hoping for a lucky strike from a 1031 exchange, non-contingent cash buyers are beginning to approach endangered species status. There is a lot less country club equity (and if dues keep rising, a few less country clubs) looking to bid unless sellers reduce expectations and asking prices. While non-motivated sellers have typically tested the waters by pricing today's assets at tomorrow's prices, the majority of experienced operators have taken their priced to negotiate properties off the market. Motivated sellers still exist through estates sales, partnerships dissolving, and divorce, surprisingly these owners that are compelled to sell are having difficulty making it to the alter. Sellers often holstering recent appraisals are facing off with buyers armed with bank commitments that require lower LTV's and higher debt coverage ratios, resulting in diminished cash on cash yields for purchasers.

Cap rate compression turns into cap rate depression for sellers unable to offer either an assumable mortgage in place or unwilling to hold a private money mortgage. Buyers celebrate the New Year reviewing "for sale listings" that have become "on sale" listings with capitalization rates flirting between 7.75% - 8.25% (B & C assets). Regardless of cap rates heading north, forward thinking buyers are not rising to the bait. Buyers want to be compensated for having the decreased upside potential associated with a softening market. Pessimism is being priced into pro-formas. The going in rate of return is downplayed by value added buyers who recognize above market income streams can turn to a trickle as short term leases burn off.

Real estate professionals agree the best time to sell a property is when you don't have to, but the tide might be too strong for some landlords to sit out this down cycle. If commercial properties remain under leased and expenses continue to rise, Long Island might see the first ripple of distressed owners who will be forced to go deep into their pockets when its time to refinance. Opportunistic buyers with capital capacity must practice patience, as the window to take advantage of market dynamics might be just around the corner.

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