This article is sponsored by the
Society of Industrial and Office Realtors® Foundation.

Promoting and supporting initiatives that educate, expand, and enrich the commercial real estate community for 48 years. Sponsorships made possible by charitable contributions.

The SIOR Foundation is a 501 (c) (3) not-for-profit organization. All Contributions are tax-deductible to the extent of the law.

When It Comes to Financing, Everything Old Is New Again

Steve Lewis is the President of Wordman Inc., a marketing and public relations firm in Atlanta, Georgia. He served as Editor of the National Real Estate Investor for eight years. He was also the Real Estate Editor of Business Atlanta and the Editorial Director of the real estate group of publications at Communications Channels Inc., which includes Southeast Real Estate News, Southwest Real Estate News, and Shopping Center World. His firm represents developers and contractors in the Atlanta area, and he continues to write freelance articles about the real estate industry.

By Steve Lewis

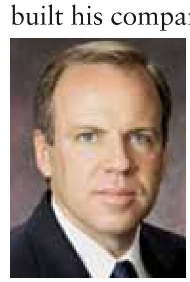
Do you remember master leases? How about sale-leasebacks? If you do, it may be time to dust off some of those old strategies. In this economy, you have to search for ways to make financing work. If you don't remember the old strategies, it may be time to learn.

"Recently, a buyer said they would lease a property from the seller and spend money to improve the property in order to have more equity when they closed," says **Matthew G. Cravey, SIOR, CCIM, RECS,** of NAI Cravey Real Estate Services in Corpus Christi, Texas. "The seller was so happy to see some cash flow come in and service his debt that it sounded like a great deal to him. That's old school (what we used to do in the '70s); we had owner financing and master leases."

During that time, he recalls, the master lease was very common.

> *"If you don't remember the old strategies, it may be time to learn."*
>
> — Steve Lewis

"They'd master lease the whole property and pay one rent. The seller would still own the property, and the buyer would get any cash flow over what the seller needed for expenses, and would fix up the property," he explains. "That's how Conrad Hilton built his company."



David A. Volk, SIOR, Vice President of CB Richard Ellis Brokerage Services in Tucson, Arizona, used a similar strategy to close a difficult deal. "We had a building owner who wanted to sell fairly quickly and had assumable financing with at least 30 days' notice to the bank, which had to approve the assumption," he explains. "Special Services called back and said it would take them five months. But the deal had to happen more quickly, and the buyer/user had to move in, so after a couple of weeks negotiating over Christmas we had the buyer sign a six-year master lease and pay the seller as rent an amount equal to the mortgage payment. Whenever the note could be assumed, the buyer would become the landlord and tear up the lease."

In the "old days, (about 20 years ago)," Volk continues, "You would have done a 'wrap' mortgage. This recent deal is a glorified, modernized version of the old wraparound—a more creative way. The seller has to stay involved as owner-manager to make the transaction pure and above reproach."

Volk points out that, in this situation, "If nothing else happened, you'd have to refinance after six years anyway." As it turned out, however, "We opened up escrow for six years, but it ended up taking about four months."

For owner occupied buildings, "sale leasebacks, rather than refinancing, can make sense, especially if estate planning is a factor," says **Whitney E. Kerr Jr., SIOR, CCIM,** Vice President, Principal, Cassidy Turley in Kansas City, Missouri. "By bringing in an equity investor who gets a preferred return [on investment properties], a distressed owner may keep his property," he notes. "Half a loaf is better than none, isn't it?"

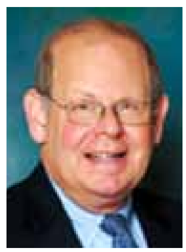
Creative Equity Sources

Lenders today are looking for much more equity than they were several years ago, and here again, SIORs are getting more and more creative. "We brought in a piece of property that had no income," says Cravey. "If we did certain things, we could create value, but we needed 30 percent equity. We had raw land free and clear that we could we put up as additional collateral, but that's the past." Some banks, he notes, depending on their ratios, have problems with that and still want to look at your ability to repay.

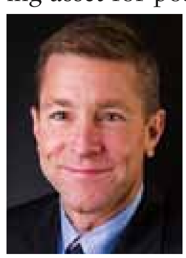
"The property made no income, and the land had no income," he explains. "They wanted to know how we were going to make payments, and that's a legitimate question. We came back and said we'd sell off part of the property. They asked how long it would take. What they ought to be doing is asking better questions. Some still take the easy way out by saying they just won't take the loan."

"Institutions are requiring that additional capital be put in transactions," adds **Jonathan J. Gelman, SIOR,** of Gelcor Realty, Inc., in Fort Washington, Pennsylvania. "With cap rates changing, sellers are getting more aggressive about selling to individuals. If individuals have big net worth they can go to their financial advisor or investment house. I've seen institutions lend individuals up to 50 percent of a portfolio at below a 3 percent rate."

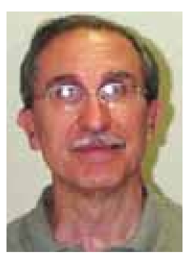
Gelman adds. "I've even fooled around with it" and was able to get money at 2.25 percent. "Well-heeled companies," he says, "do not have a problem; they just go to their credit lines to buy assets."



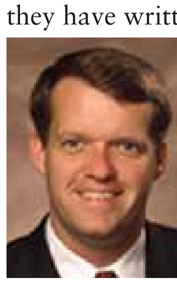
Arlon I. Brown, SIOR, Senior Vice President, Parsons Commercial Group, Framingham, Massachusetts, reports, "When a smaller commercial investor has gone for an annual review or to refinance a property, and the Loan to Value (LTV) after the appraisal does not meet the institution's current underwriting criteria, the institution may look to another performing asset for position in that property.



Clay Culbreth, SIOR, CCIM, Vice President with Thalhimer in Virginia Beach, Virginia, sees owner financing and the use of IRA and 401k financing as growing trends. "I am really trying to learn more about putting my IRA/401k to use in commercial financing—be it a mortgage or paying cash," he says.



"One thing that I feel you will see more of is note sales, where a buyer will buy a particular note at a distressed price and most likely get a 'deed in lieu' or may have to foreclose," says **Stephen V. Jacquemin, SIOR, CCIM,** S.J. Financial Group, Inc., Ellisville, Missouri. "The note buyer at the closing becomes the bank and the bank gets this off their books; typically they have written down the loan to that amount."



A. Scott Hensley, SIOR, CCIM, a partner in Charlotte, North Carolina-based Piedmont Properties/CORFAC International, says he has recently used three strategies to close deals: seller financing, cash, and leasing with an option to purchase.

> *"Lenders today are looking for much more equity than they were several years ago, and here again, SIORs are getting more and more creative."*
>
> — Steve Lewis

"Whatever you do, Mr. Building Owner, keep your tenants"

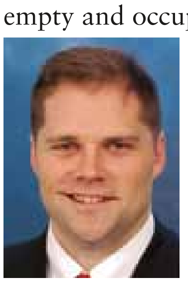
— Steve Lewis

"An analysis of the last 15 sales transactions at our company indicates that 60 percent were all cash, 20 percent seller financed, and 20 percent involved a traditional lender," he says. "One creative solution we structured was a lease with option for ownership. We had a vacant building with very little tenant interest, so we decided to structure a deal where the tenant signs a five-year, NNN (triple net) lease at a fair market rate, with few concessions. At the end of the five-year term, if the tenant is not in default, he or she is granted 15 percent ownership. While we will give up some ownership, my pro forma [income statement] indicates we more than make that up in the way of increased income over the five-year term."

"Dear Client . . ."

Because of the changing environment for financing, **SIORs** find they have to educate their clients about those changes and advise them how best to position their companies and their properties.

"Do not lose tenants—I repeat, *do not lose tenants*," advises Kerr of Cassidy Turley. "Whatever you do, Mr. Building Owner, keep your tenants. Give them tenant improvements, free rent, and if necessary, a minority ownership interest in the property. The lease is what creates value. A building is worth far less empty than fully occupied. Case in point: Consider the difference in value between the sale price of the Microsoft building in Seattle ($530 per foot) versus the WAMU building ($130 per foot). [They're both in the] same market. One building was leased to a triple-A credit tenant and the other was empty," he says. "So what's the damage to an owner staring down the gun barrel of foreclosure from peeling off a small ownership piece in order to keep his big tenant? Not much, when you consider the difference in value between empty and occupied."

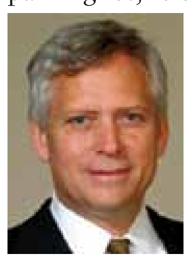


James Bach, Vice President, CBRE Capital Markets – Debt & Equity Finance, Seattle, Washington, agrees. "Get those buildings leased," he emphasizes. "I went to a Mortgage Bankers Association (MBA) meeting where they said there is more money this year than last, but lenders will still not take unleased buildings. They want stuff that's leased, with a good-quality, decent tenant roll and something that's leased over time—not for just one year."

"Make sure your financial house is in order and that you have a good story to tell," says **Stuart J. Kingma, SIOR,** Vice President, Senior Director of Industrial Services, The Wisinski Group, Grand Rapids, Michigan. "The days of putting a business plan on a napkin are gone. Be prepared to commit more resources to the project; provide guarantees—personal ones are talked about a great deal. Help your clients understand that, without a good plan with good collateral and payment potential, you will not get to step one with lenders."

"The banking industry, especially the business of lending, is becoming once again a relationship business," says Hensley. "Clients need to work on developing a good relationship with their banker and to keep them informed of what is going on with their business. Communication is even more important now. If a client is having problems, it is better to let their lender know early on, instead of waiting until it is too late."

"You really have to get back to basics," adds Brown. "You have to sit down and get your strategy in place—what are plusses of the property, and what are the minuses? Emphasize the plusses, and cheaply improve what you can to be competitive—like seal-coating a parking lot, re-striping it, or adding more landscaping."



When working with owner-users, you have to prepare them for a lot more paperwork, says **Douglas A. Stockham, SIOR, CCIM,** of Asset Specialists, Inc., in Palm Beach Gardens, Florida. "I even got a new-customer form from a bank," he says. "I explained to them that I was there when the bank was formed and became a customer two days later, but they said every time you renew a loan you're a new customer."

Cravey adds that one of the toughest challenges he has is teaching clients that in today's market, patience is a virtue. "One of the hardest parts of our job is getting the sellers to give the buyers enough time to find their source of financing," he says. "The sellers living in the past are conditioned to a higher price, but they have to get past that. Now they have to be conditioned to allow the buyer to put his financing together."

"You really have to get back to basics, you have to sit down and get your strategy in place"

— Arlon I. Brown, SIOR