

COMMERCIAL REAL ESTATE

Deal, No Deal

BY: JEAN GRUSS | EDITOR/LEE-COLLIER



Kyle Burd is regional vice president for Eola Capital, which made the largest commercial real estate purchase on the Gulf Coast so far this year — the \$19.4 million acquisition of 500 N. Westshore Blvd. in Tampa.

Sales of commercial properties on the Gulf Coast have fallen 82% so far this year. Buyers and sellers are still far apart on price, but some think activity may pick up by the end of the year.

Here's an indication of how tough the commercial-property market has become.

Orlando-based Eola Capital and an undisclosed seller came within 2% of closing on a deal for a commercial building in the Tampa area before both sides walked away. "We just couldn't close the gap," says Kyle Burd, Eola's regional vice president in Tampa. "There wasn't the motivation."

In the commercial real estate boom that peaked a few years ago, a narrow gap would never have halted a deal. But in this downturn the smallest molehills turn into insurmountable obstacles.

On the Gulf Coast from Tampa to Naples, the volume of commercial-property sales has fallen 82% in the first five months of 2009 to \$137 million compared to the same period in 2008, according to Real Capital Analytics. There have been just 15 transactions so far this year exceeding \$5 million, down 69% from the 48 in the same period last year.

"We're experiencing that everywhere," says Jessica Ruderman, senior analyst with Real Capital Analytics. Nationwide, commercial-property sales are down 75% in that same period. "Buyers and sellers haven't agreed on a price yet."

Agreeing on prices is difficult because the future is so uncertain. Vacancy rates are rising, rents are falling and it's not clear when the economy is going to turn around. Lee DeLieto, broker and senior member of DeLieto & Associates in Sarasota, says buyers are asking themselves: "It's going to get worse, why are we jumping in now?"

But unless they're desperate, sellers aren't willing to take lowball offers. "Up to this point, since the market really fell off, buyers have been expecting sellers to do all the capitulating," says Larry Richey, senior managing director with commercial brokerage Cushman & Wakefield in Tampa. "Now, we're starting to see some of the sellers push back."

Sellers may be under growing pressure from lenders, however. Millions of dollars of commercial mortgage-backed loans are coming due and low valuations mean many property owners will either have to come up with more equity to refinance or sell the buildings in a depressed market.

"It's a significant issue," says Lee Arnold, chairman and chief executive officer of Clearwater-based Arnold Cos.

In hard-hit areas such as Fort Myers, property values have declined so much that many borrowers have seen their equity evaporate. "There's nothing that will reverse the trend of declining values in the next 24 to 36 months," says

Gary Tasman, executive director of Commercial Property Southwest Florida, a Cushman affiliate in Fort Myers.

Those declines may finally attract buyers who have held off. Arnold and others are reporting increased activity in the last 30 days. "People are unloading properties they can't afford," Arnold says. "We picked up hundreds of millions of dollars in transactions in the last 30 days. My top workout people are very busy."

Money on the sidelines

So far this year, buyers are waiting for sellers to drop their prices. They have capital, but financing is limited and lenders are requiring more equity in the deals. "Leverage is the fuel that runs the engine of transactions," says Richey.

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Buyers' patience has paid off as values have continued to decline. "In retrospect, they've been pretty smart," says Tasman.

Arnold projects that upcoming deals are getting priced at 40% to 50% of mortgage value. "The dollar volumes are going to be quite low," he forecasts.

The top deal in the Tampa Bay market so far this year was Eola Capital's acquisition of a 130,000-square-foot office building at 500 N. Westshore Blvd. in Tampa for \$19.4 million. That's about \$149 per square foot, perhaps as much as half of what it would cost to build new.

Burd declines to reveal how he put together the 500 North Westshore deal. "The only thing I can tell you is that we had a motivated seller and buyer," he says. The building is about 90% occupied with small tenants and no single tenant occupies more than a fraction of each floor. "We felt like the pricing was commensurate with the risk," he says.

But the Westshore deal is more the exception than the rule these days. Among other issues, sellers are waiting to see how the federal government bails out troubled commercial loans. "There's a lot of kicking the can down the road going on," says Richey.

Hard to value

It's hard to value commercial buildings with so few sales and such low prices for buildings that do trade — a problem similar to the one that be-deviled the residential market because of rock-bottom foreclosures. One way to value properties is to dial back the clock to pre-boom times. "We're getting back to looking at values in 2002 and 2003," says DeLieto.

And buyers are looking carefully at the tenants. "You have to go back and see if the rents are inflated and whether the tenants are questionable," DeLieto says.

A common way to value buildings is to use the capitalization rate, or "cap rate" for short. It's percentage result of dividing a building's net operating income by its price. In the boom, cap rates fell to 5% and 6% as buyers bet that property values would increase. Now, most are expecting cap rates to reach 8% to 10% or higher. "The days of nine and 10 cap rates are not that far away," says Tasman.

But with so few sales to use as comparisons, it's hard to say whether one building deserves a 6% cap rate and another a 10% cap rate.

Buyers "are not looking at cap rate or internal rates of return," says Richey. "They're looking at cash-on-cash returns using conservative assumptions."

Whatever the method to value, there is little doubt values can fall further. When they do, buyers who have held off may pounce.

"There's capital out there," Arnold says. "My investment brokers will shine by year end."