

## Perspectives on Commercial Real Estate

### Relativity



by Tony Michelman

*Down by the beach, an unfortunate, senseless crime was committed:*

*A snail got mugged by two turtles.*

*After the incident, police detectives questioned the snail about what happened.*

*"I don't know what happened," sighed the shaken snail. "It all happened so fast!"*

Relatively speaking, changes are occurring at breakneck speed in the financing of commercial real estate. After years of free-flowing capital, the collapse of the subprime lending sector has caused dramatic cutbacks in liquidity.

Consequently, it's suddenly a very different marketplace from a pricing standpoint.

The Commercial Mortgage Backed Securities market (CMBS) – where mega loan packages that drive much of commercial lending emanate – is in an unprecedented period of volatility. There's a lot of unsold inventory. Even worse, the erratic behavior of finance rating agencies in the subprime debacle has made risk calibration a shaky endeavor.

It's pretty hard to price financial products when confidence has been lost as to what value really is.

Is this a total catastrophe? A momentary setback? An opportunity?

Well, we enjoy Chinese food. Or, as the Chinese call it – food. Catch our drift? It all depends on where you happen to be sitting. What your capabilities and priorities are.

How you see the real estate world on both a macro and micro basis.

Or maybe where you live.

The subprime virus has spread across the country taking down the most vulnerable communities. For instance, there are a lot of new retail centers in the Midwest that already had high vacancy factors. It's very difficult to reposition assets like that during a credit crunch.

In California, some cities which saw property values increase at meteoric rates are plummeting like a cold comet. Land sales in Modesto and Bakersfield are half or less of what they were a year ago.

Los Angeles is another story.

There is a dearth of vacant land available here. There hasn't been all that much new construction over the last decade. There isn't an oversupply of commercial product. There's a shortage.

Despite the national carnage, all the local underlying funda-

mentals are still relatively intact. Nonetheless, prices in Los Angeles could easily fall by 15% or more over the coming year.

Not so bad...Relatively speaking.

*In deep prayer, a man suddenly looks up to the heavens. "God," he says, "I would like to ask you a question."*

*To the man's shocked surprise, God answers: "No problem. Shoot."*

*"Uh, is it true, God, that a million years to you is but a second?"*

*"Yes, that is true."*

*"Well, then, what is a million dollars to you?"*

*"A million dollars to me is but a penny."*

*"Ah, then, God ... May I have a penny?"*

*"Sure," says God, "Just a second."*

In life, timing is everything. If you bought Microsoft at stock inception, you'd be rich. If you crossed the street ten seconds earlier, you might have gotten hit by a bus.

Historically, those who do best in real estate investing are those who adeptly time cycles. Buying low and selling high. Leveraging money through financing and often returning profits unachievable in traditional, certificate-driven markets.

The knock on real estate investing was always twofold:

- 1) Lack of liquidity.
- 2) Lack of professionalism industry-wide.

In the global economy, things had supposedly changed. With commercial real estate products available worldwide, with REITS, with greater transparency, with more education throughout the industry's workforce. The risk, many thought, had been mitigated.

So what happened? Buoyed by these new perceptions investors started taking even greater risks is what happened!

And though commercial is an entirely different animal than residential real estate, the companies that finance both are similar. The residential subprime meltdown traveled to the commercial sector via a commonality in lending practices.

At the end of the day, real estate markets will always be comparatively inefficient to Wall Street and most stock markets around the world. Real estate is an entrepreneurial proposition. The economics of land and building development are more project and locale specific.

There is no definitive formula, no definitive truth. In real estate, all truth is relative.

Absolutely.

**Tony Michelman is  
Vice President of  
NAI Capital and Real Estate  
Advisor to the Los Angeles  
Community Colleges.  
He can be reached at  
818-742-1621 or  
tmichelman@naicapital.com**