

“7 Come 2011”

A bet on commercial real estate that you have to make!

There have been hints for awhile that some of the most well-known titans in the industry were about to be dealt some major losses. Last week's news was that the deal for Peter Cooper Village and Stuyvesant Town, Manhattan's most high-profile apartment complex, appears to be moving toward default. According to the report in the *Wall Street Journal*, the equity investors and many of the lenders associated with this apartment complex, including several state pension funds, may well see most (if not all) of their investment gone.

This news serves as yet another reminder that there is much more pain in store for investors, particularly those with loans coming due during the next few years on properties bought at the peak and who leveraged accordingly. Between whole loans held mostly by banks (mostly small cap or regional banks) and commercial mortgage-backed securities, we can expect approximately \$1 trillion in write-downs with the majority of this distress to occur over the next 3 years. We are entering into a stretch where these bad rolls of the dice are showing up.

In the case of Peter Cooper Village, the current estimated value of the property is slightly less than half its \$5.4 billion purchase price in 2006. Beyond being catastrophic for these investors, this reduction in value is frightening for those of us wondering how much lower property values and prices will go before hitting bottom. Most of the industry thought (or hoped!) the percentage decline in prices would not drop to the levels reached in 1992, but with unemployment still increasing and property fundamentals still deteriorating, there is no reason to expect that demand (and thus values) for commercial property is going to increase anytime soon.

According to Real Estate Research Corporation's (RERC's) third quarter 2009 institutional investment survey respondents, values and price levels are expected to drop further. Although preliminary measures indicate the relationship between value and price has improved slightly since second quarter, the third quarter rating of 4.7 on a scale of 1 to 10 (with 10 being high) indicates that the overall price of properties still exceeds the value and that more write-downs are to come. One investment advisor who responded to the survey noted that it could be a long time—after 2011—before prices stabilize, while yet another investment advisor said that “we are closer to the bottom than the top, but we still need to see a higher volume of transactions before I will have confidence in investing again.” Another survey respondent expects additional declines in the near term, and does not expect price and value increases until 2013.

Although most investors do not want to stand back up at the real estate table until prices have stopped declining and have stabilized, RERC estimates that it will be early 2011 before shaky hands quiet themselves. Investors preparing for this eventuality can take heart that well-tenanted properties in solid locations are still valued by core investors. It will take courage, conviction, and decisiveness to stay at the table and wait until 2011 for the industry to become flush with capital again. Life is a gamble, and “7 come 2011,” commercial real estate is still a bet that you have to take!