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Serving clients, communities with creative solutions

Team Leader Imran Bhaidani, Keller Williams Southwest

NAR

FALL 2023

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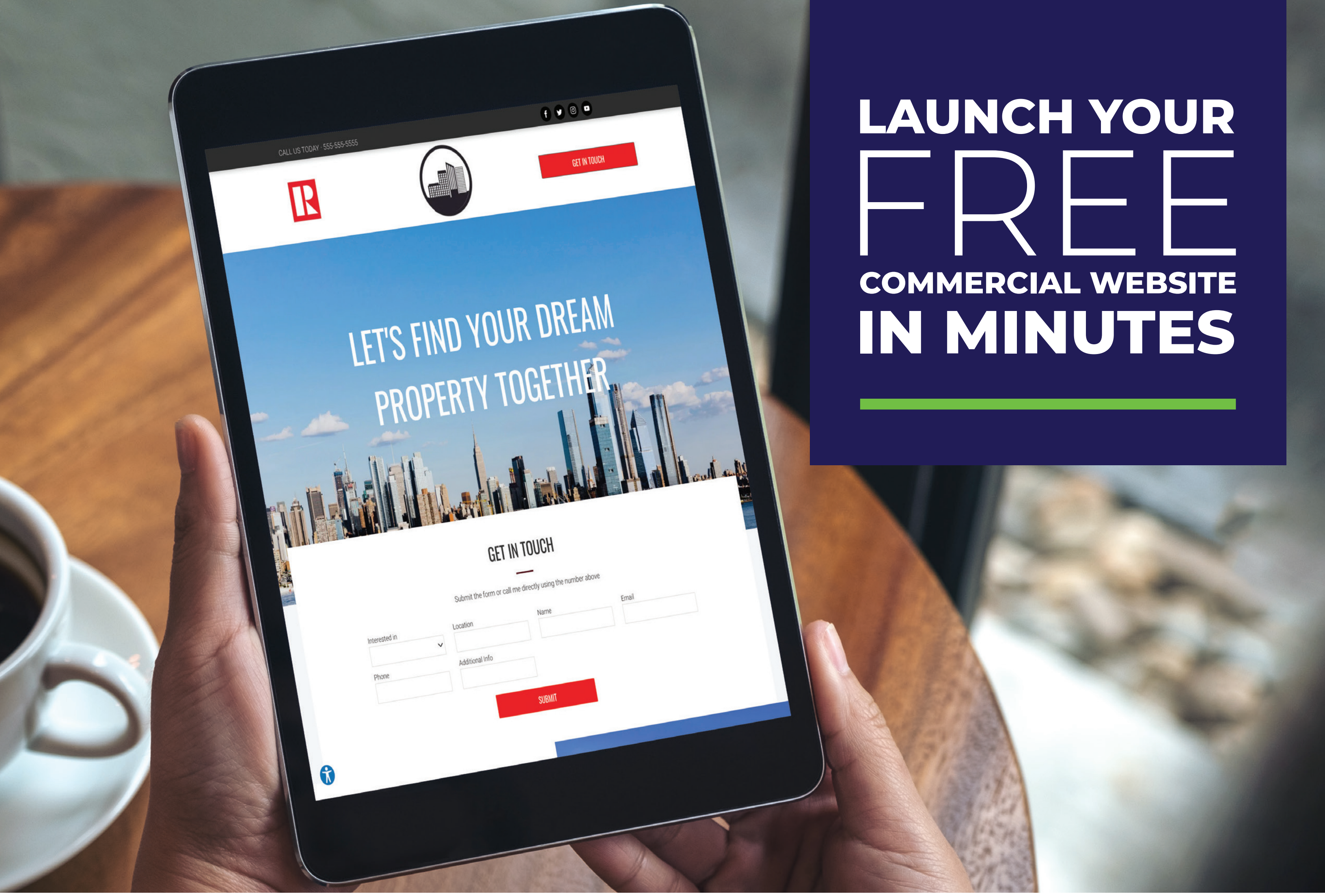

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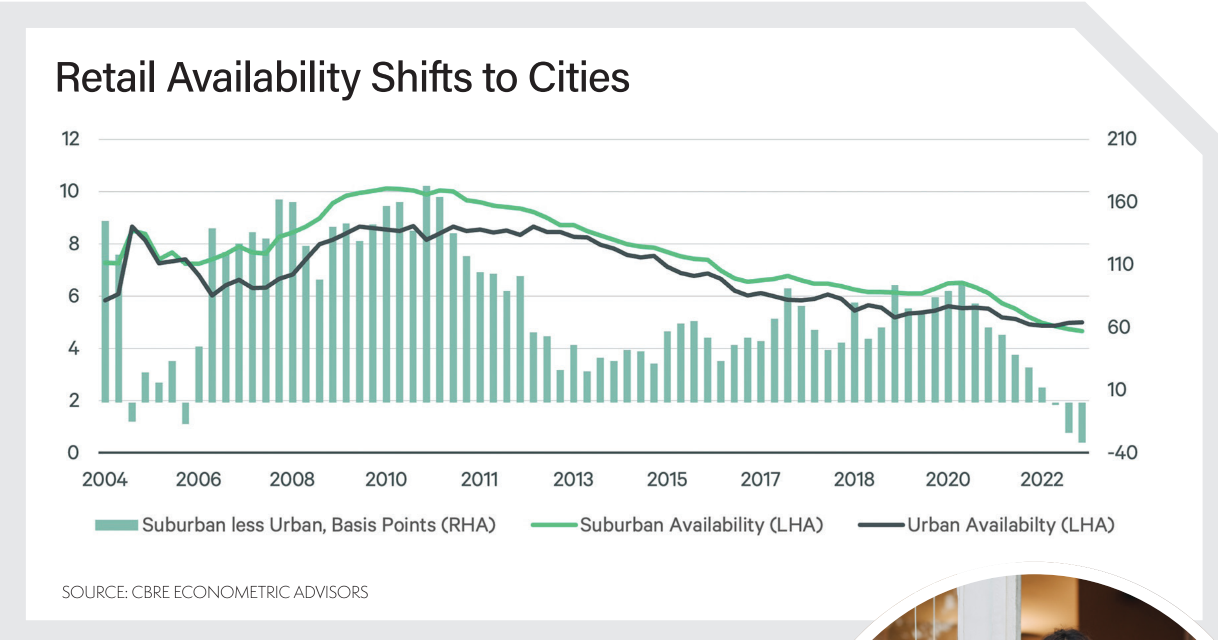
Retail

Hip Shopping Goes Suburban

Spending follows millennial, Gen Z migration.



For the first time since 2006, the retail availability rate across U.S. central business districts has surpassed the rate in the suburbs, according to CBRE data. As workers more rarely commute to urban offices, they're spending more money in the areas where they live, says CBRE.

Suburban Migration Feeds Retail, Restaurants

On top of that, millennials and Gen Zers are starting families and departing city neighborhoods for the suburbs. "However, they still want the great chef-driven restaurants and trendy retail they had in town," says Molly Morgan, executive vice president of retail leasing at JLL, as reported in *GlobeSt.com*. "Developers have met the demand for mixed-use, suburban downtown areas that create an experience hip retailers and restaurants are looking for, and they are seeing great success." Examples include Halcyon in Alpharetta, Ga., a suburb of Atlanta, and Birkdale Village in Huntersville, N.C., a suburb of Charlotte.

Retail town centers developed by Macerich, a retail owner, operator and developer, are gaining traction in attractive suburban markets. "Post-pandemic, people are demonstrating entrenched preferences to continue shopping, dining and finding great entertainment close to home," Doug Healey, Macerich senior executive vice president for leasing, told *GlobeSt.com*. "Hip retailers are certainly mindful of this ongoing trend."

Adapted from "Urban Retail Availability Increases as Suburbs Flourish," written by Richard Berger and published in the July 17, 2023, edition of GlobeSt.com.

"People are demonstrating entrenched preferences to continue shopping, dining and finding entertainment close to home.

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Best Practices

When Social Media Bites Back

Avoid surprises through social listening.

Social media problems don't always rise to the level of massive missteps that result in millions of dollars in lost revenues or the ouster of a CEO. They can involve a dissatisfied client posting a complaint about your brokerage or your business publishing a post that offends a reader.

If your business faces a tough social media situation, it can recover. In a recent survey by Sprout Social, a provider of social media software, 89% of respondents said a business can regain trust if it quickly admits a mistake and openly states how it will fix the problem.

A Success Story

Slack, the business messaging app, handled negative social media posts very well after a major outage in 2022, says Petia Abdur-Razzaaq, CEO of The Stylista Group, a digital marketing agency in New York City. "People were on social media asking what was going on and complaining they couldn't do their work. Slack responded almost immediately and apologized. After that, Slack kept giving updates until the app was up and running again."

Use Social Listening

The element of surprise makes it difficult to develop quick responses to social media problems. To make surprises less likely, use "social listening," recommends Abdur-Razzaaq. This practice involves frequent searches of social media to find out what people are saying about you or your company. You can do this through tools such as Google Alerts or dashboards from Hootsuite or Sprout Social, many of which are available for free or at a low cost.

Adapted from "Social Media Crises: Response + Prevention" by Rachel Antman, published in the Summer 2023 issue of SIOR Report. *Antman is founder of Saygency LLC.*

Conversion Stars Align in Alexandria, Va.

The city is a leader in office-to-residential transformations.

Who would have thought Alexandria, Va., would take second place, just behind Los Angeles, in office-to-residential conversions in 2022? That's what Rent Café reported last year.

The credit goes to location, luck and good development partners, says one of Alexandria's principal planners, Maya Contreras, in an article published by *Bisnow*.

Alexandria's conversion appeal also stems from structural factors. Christina Mindrup, vice president of real estate at Alexandria Economic Development Partnership, told *Bisnow* that the presence of standalone buildings, and floor plates that are generally smaller than those in larger cities, makes for easier conversions.

Most of the conversions are near Alexandria's Old Town neighborhood, according to *Bisnow*. Completed projects include:

- **Park + Ford:** USAA Real Estate (now Affinius Capital) and Lowe converted three 1980s office buildings into 435 apartment units and 115,000 square feet of office space.
- **Town Gate North:** Brookfield Residential transformed two former office buildings into 81 condo units.
- **801 North Fairfax:** Abramson Properties converted a 60,000-square-foot office building formerly occupied by the Alexandria Chamber of Commerce into 54 condos.

Additional projects are in the conversion process or planning stages.

It doesn't hurt that the city is developer-friendly. A program in Old Town North allows developers to add density if they include space for community arts use, *Bisnow* reports. Mindrup says the city is also adept at working with the state government to provide developers with incentives.

Adapted from "How Alexandria Has Become a National Leader in Office-to-Residential Conversion," written by Emily Wishingrad and published in the Aug. 17, 2023, edition of Bisnow.

PHOTOS COURTESY OF LOWE

Park + Ford, Alexandria, Va.

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Standoffs

Big Warehouse Projects, Big Pushback

Developers face 'no deal,' as areas tighten control.

Developers' plans to build mega warehouses and logistics facilities—new or via adaptive reuse—are meeting hefty opposition, including civil lawsuits, from residents and municipalities. The objections typically center on potential traffic snarls, road deterioration, and health and environmental concerns.

A Policy With Regional Reach

A state planning agency in New Jersey has taken a regional approach to overseeing warehouse development. The New Jersey Highlands Council released a policy document prohibiting warehouses within a region that's more than 1,250 square miles, according to CoStar. The limits apply to designated preservation areas plus protection and conservation zones, CoStar's Linda Moss reports. The council also released new requirements for warehouses it's permitting in parts of the region.

No Go for Adaptive Reuse

Although standoffs are prevalent in New Jersey and California, they're also occurring elsewhere. In suburban Chicago, Bridge Industrial withdrew its proposal to redevelop Baxter International's campus into an industrial park, says The Real Deal. Bridge had wanted the village of Deerfield to annex the campus, planning to tear down the buildings and construct a 1.1-million-square-foot logistics hub and sports center, wrote Miranda Davis. After local leaders and residents failed to support the project, Bridge decided to drop the plan, including the purchase of the 101-acre campus.

Risk Reduction

GETTING THE PICTURE ON PHOTO COPYRIGHTS

Here are four ways to avoid violation claims.

Commercial real estate professionals have long relied on photos for listings and other marketing-related communications. But as the use of online images has increased, so has easy access to photos from diverse sources—and the risk of copyright violation.

Using a copyrighted work without permission is an infringement and could result in liability. A court could award injunctive relief, damages and attorneys' fees, and order the infringing materials to be destroyed.

Chloe Hecht, senior counsel for legal affairs at the National Association of REALTORS®, recommends four risk management strategies to avoid copyright infringement claims:

1. Don't use third-party work in your business materials unless you can determine the owner and receive permission. Ownership isn't always clear, so allow time to do research and communicate with digital photographers.

2. If you get permission, document it in a license agreement that describes the scope of your permitted use, including how long you can use the work, the media where you can use the work and any geographic restrictions.

3. For listing photos, you need an agreement with the photographer. NAR has created sample photo agreements for members. If you own the copyright to listing photos, save the images in your own files and avoid downloading them from commercial listing websites.

4. Save copies of your license agreements. That way, if anyone challenges your use of third-party work as unauthorized, you can prove you had permission.

nar.realtor/video/copyright-issues
nar.realtor/photo-sample-agreements

Multifamily

Rev Up Revenues With Onsite Markets and Pet Perks

Offering renters unique services helps owners capitalize on unused spaces.

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Landlords and property owners who are looking for ways to compensate for higher operating costs might consider new ideas to ramp up revenues. "You can start by looking at dead or unused spaces in your buildings," says Jae A. Roe, CPM, president of SOVA Real Estate Solutions in Newport News, Va.

Cashier-less Markets

Think creatively about how you can put that unused space to work. Mini and micro markets are an excellent option because they're generally unmanned retail space, says Roe. "They can provide much of the same functional services as a vending machine, but they look much more like a convenience store or the in-building café many have grown accustomed to." The concept is especially popular in locations with irregular hours of operation, where staffing would become a concern, she adds.

A Premium on Pets

Another opportunity for multifamily properties: pet services for residents. These services can range from pet sitting to complete grooming. Forty-five percent of U.S. households own a pet, a 7% increase since 2016, according to the American Veterinary Medical Association. Several studies have shown that millennials make up a large segment of both multifamily residents and pet owners. In fact, some renters consider their pets so important that websites are including ratings of multifamily properties based on pet-friendly policies and amenities.

Adapted from "Revenue Recharge," written by Will Curtis, CCIM, CPM, and published in the Summer 2023 edition of the Journal of Property Management.

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Markets

Multifamily, Senior Housing Deals Are on the Rise

Purchase and sale activity contradicts a cautious lending environment.

Opportunities abound for sales in the multifamily housing market, particularly the senior housing sector, according to commercial real estate experts polled for DLA Piper's 2023 Mid-Year Real Estate Trends Report, which analyzes the views of CRE leaders on their outlook for various asset classes and investment markets. The industrial sector, including logistics hubs, warehouses and cold storage facilities, also continues to shine, the report says.

While lingering inflation, high interest rates and maturing loans have made commercial real estate investors and lenders cautious—translating into a significant reduction in transaction volume and a reduction in value for many asset classes—several regions are thriving, the report says. The most active markets include Boston, Florida and Washington, D.C.

Apartment complexes, student housing and mobile home communities drive a sizable portion of the law firm's acquisition and disposition work. The group also saw an increase in retail, hotel and data center deals in the first half of the year.

In addition to acquisitions and dispositions, DLA Piper's clients continue to see steady activity in leasing, land use and permitting, and joint ventures.

The survey data reflect 675 purchase and sale agreements and more than 200 property management agreements.

dlapiper.com/en-us/insights/publications

DONE DEAL

Commercial real estate pros, bringing perseverance and creativity to their work, can make a positive mark on their communities. Here are three NAR members who handled special, sometimes tricky circumstances on the way to closing.

BY DAVID A. GOLDBERG

A new retail development at Harvest Green, a 2,000-acre, master-planned "agri-hood," will deliver on green-space and architectural requirements while creating an estimated 150 jobs. On page 2: The Farmhouse is the community clubhouse at Harvest Green.

©JOE ABRAHAM

The Market Center at Harvest Green

Imran Bhaidani, B&P Team Leader, Keller Williams Southwest, Metro Houston

In Imran Bhaidani's telling, the 7.4-acre site had it all: Sidling up to a bustling arterial, the vacant parcel would be the gateway to a new phase of Harvest Green, a 2,000-acre, award-winning community planned around a working farm in the most sought-after quarter of metro Houston. The property's visibility was further supercharged by being across from a 1,200-student middle school and a stone's throw from a high school of 2,500.

But the site also presented challenges. It sits in an "extra territory" jurisdiction just outside the city of Richmond, in Fort Bend County, making any project subject to multiple regulatory requirements. And then there were the exacting standards of developer Johnson Development and the community's architectural review committee, charged with enforcing the neighborhood's "modern agrarian" theme.

All that to say that, in the pandemic year of 2021, Bhaidani was a suitor with multiple audiences to please when he came calling on behalf of his buyer—a repeat customer—to pitch his concept for a Class A neighborhood commercial center. Rather than a could-be-anywhere strip mall, it would offer a mix of local and national tenants and community-serving amenities: tree-lined walkways, open green space, planters with seating, a phone-charging center, electric vehicle chargers and, of course, compatible and appealing architecture. It would be the neighborhood center the community of 10,000 needed.

"It's important to create a concept for your buyer that will work on any particular tract," Bhaidani says. "But then we have to back it up with facts and analysis. We have to be very sure of the numbers: the costs, returns to investors, the financial and technical feasibility of what we're proposing."

Bhaidani hired a real estate attorney to negotiate the deal, looking for an extended period of due diligence given the prolonged turnaround times amid the pandemic. "That turned out to be critical," he adds. Then, he helped the buyer line up consultants to perform topographic and environmental studies and retail, leasing and construction cost analyses. Though the property is just outside the city limits, Texas regulations allowed the city of Richmond to request an additional traffic analysis, as well.

Bhaidani then helped the buyer raise about $10 million from accredited investors. "We were able to raise private equity through an offering memorandum, so it was essentially a cash closing." The sale closed in January 2022. Then, a long lead time to bring utilities to the site delayed the start of construction beyond the terms of the deal, requiring Bhaidani to negotiate a post-closing agreement with the developer.

The Market Center at Harvest Green started pre-lease marketing for its 40,000 square feet of leasable space as construction broke ground early in July of this year, and at that point agents had signed one tenant and secured two letters of interest. "In addition to retail, we are hoping for medical offices, restaurants, a tutoring center and other neighborhood services," Bhaidani says.

Takeaways: In this deal, it was important to consider the interests of the master-planned community while acting in an advisory capacity to shepherd a project that would not only be financially viable but also serve the needs of residents, community members and patrons. That meant added costs, but it likely also sealed the deal. "A lot of commercial property buyers are looking only at profit, but in this case, they were looking for a balance of ROI and creating a good place for the community," Bhaidani says.

Beck Aesthetic Surgery Center

Donald Beck, CCIM, Principal, Interurban Properties, Charlotte, N.C.

Dr. Joel Beck's cosmetic surgery practice was in serious need of a facilities facelift. And as it turned out, his commercial broker brother was just the man for the operation.

In a bid to improve his quality of life and reduce his cost of living, the plastic surgeon in 2018 had made the bold decision to relocate from the San Francisco Bay Area, where he had built a robust practice, to Charlotte, N.C., where his brother Donald, CCIM, lived. For a time, he practiced on both coasts, gradually shifting his time and attention away from California and toward Charlotte, where his practice was crammed into a 1,981-square-foot office his brother had found as transitional quarters. (His California office had been 3,500 square feet.)

By 2020, Dr. Beck was eager to find some elbow room and fulfill his vision of a state-of-the-art surgery center. But the search for a suitable location would be complex: The right building would have to be in a location appealing to his more affluent clientele while also meeting requirements for surgical procedures he could perform onsite, rather than negotiate for time in oversubscribed hospital operating rooms.

He turned to Donald's brokerage to help navigate the shoals of competitive real estate in fast-growing Charlotte. The market for suitable locations was tight for both buildings and land, Donald Beck says. "We considered a number of options, including freestanding single-tenant buildings, Class A medical office space, as well as prime, newly renovated suburban office buildings." They were looking in "a wedge running from downtown to south Charlotte, south of the outer belt, I-485," he says.

Class A office space that was not already geared toward medical use seemed to be off the table. "We looked at one promising building that was undergoing major renovation, but the landlord balked at having clients leaving the building in a wheelchair," which sometimes happens after procedures that require anesthesia, he says.

Finally, Donald's network came through. He found a planned two-story medical building that had yet to secure tenants or start construction, just off I-485. With his brother's help, Dr. Beck began lining up specialists in surgical center design and licensing, and soon found his vision expanding from something akin to his California office to a comprehensive 11,000-square-foot showpiece. The Beck team signed up for the entire first floor.

"We had to negotiate a tenant up-fit allowance," Donald Beck says. "The cost of building out the space for plastic surgery is very expensive. So we negotiated the office area, plus the air handling and equipment requirements for the building, because you can't share surgical air with office space."

Negotiations for the $3.8 million transaction began in June 2021, and the lease was signed that October, with expected delivery of the shell building in September 2022. Although the building developer MPV Properties had tried to anticipate delays by ordering steel early, supply chain issues still delayed delivery until August 2023, meaning Beck Aesthetic Surgery Center will open in 2024.

In fast-growing Charlotte, N.C., where the market is tight for both buildings and land, the Beck team negotiated a tenant up-fit allowance to create a comprehensive 11,000-square-foot plastic surgery center.

SHELL BUILDING: ROBERT JOHNSON ARCHITECTS. INTERIOR DESIGN: IRWIN RAYMOND DESIGN & CONSULTING

Takeaways: "Available space, buildings and land are often discovered the old-fashioned way, through networking. Relocating companies are well advised to work through local brokers," Donald Beck says. In addition, "a user's space requirements can change, reflecting the input of employees, consultants, regulatory agencies and others. It is best to explore and confirm those requirements before initiating a search."

"Whether it was my brother or another broker, I couldn't have done it without one," Joel Beck says. "Especially coming into a new part of the country where I wasn't familiar, having him point out the areas of the city where it would be good for my business was critical. Knowing the competitive price per square foot helps. Knowing some credible people that we could turn to for financial help was huge."

AVAILABLE SPACE, BUILDINGS AND LAND ARE OFTEN DISCOVERED THE OLD-FASHIONED WAY, THROUGH NETWORKING.

—**Donald Beck**

An Exchange of Churches

Christopher Cockerham, CPM, broker, Cockerham Commercial of F.C. Tucker, REALTORS®, Bloomington, Ind.

AS MUCH AS WE THINK ABOUT THE INTERNET THESE DAYS, THERE'S NOTHING LIKE A SIGN SOMETIMES TO FIND THE BUYER.

—Christopher Cockerham

Sometimes in commercial real estate, you get what you pray for.

It all started in 2022, the third year of the pandemic, when Christopher Cockerham's brokerage took a distress call from Rivers Edge Fellowship Church in Bedford, Ind., 20 miles south of his home base in Bloomington. "Just before COVID they had moved into a car dealership. They turned the showroom into a sanctuary, offices and Sunday school rooms and turned a lower level into a teen center," Cockerham says. "Everything was going great until the pandemic hit. If you weren't able to pivot to an online system, you struggled, and this church did."

As the church's membership and income shrank, the costs of upkeep on the sprawling property were swallowing its reserves. Rivers Edge officials wanted Cockerham's help with selling the building and grounds as quickly as possible, while they searched for a more modest new home themselves. Preparing to market the building, Cockerham, CPM, assessed it as likely to return to a use akin to the former car dealership. He drew up a flyer touting it as a "light industrial building" with "potential for a business needing administration offices along with warehouse space and a potential showroom." As he posted signs and shipped the flyer to his 20,000-member database, in the back of his mind he figured a nearby military base might have a use for it.

Guide Pointe Pentecostal Church moved into the former Rivers Edge Fellowship Church space in Bedford, Ind. *(above, and new lobby below)*, and sold its smaller building *(not pictured)* to Rivers Edge—a win-win deal.

He did not expect the next call. Guide Pointe Pentecostal Church across town was in the opposite situation from Rivers Edge, bursting at the seams in its traditional limestone building. They had spotted the Rivers Edge "for sale" sign and thought the building looked perfect to accommodate their growing programs, including a pre-K-8 school. In the process of negotiating the sale, Guide Pointe officials asked where Rivers Edge would be going and learned that they were frantically searching for a new location. "They said, how about our building?" Cockerham recalls.

Rivers Edge jumped at the chance, and Cockerham found himself brokering a change of places between two congregations.

COCKERHAM COMMERCIAL REAL ESTATE & CONSULTING

In another twist, the move became almost literal musical chairs. Around the same time, Cockerham sold yet a third church whose new occupants needed chairs. Cockerham procured a surplus from Rivers Edge. "As a broker, you never knows what services you'll end up providing," he says.

Selling and buying churches isn't as simple as negotiating among individuals, he says. "Most churches require meeting with a board of trustees to explain the real estate process. I sat through several Sunday evening sermons so that I could talk to the congregation about how the sale was coming along."

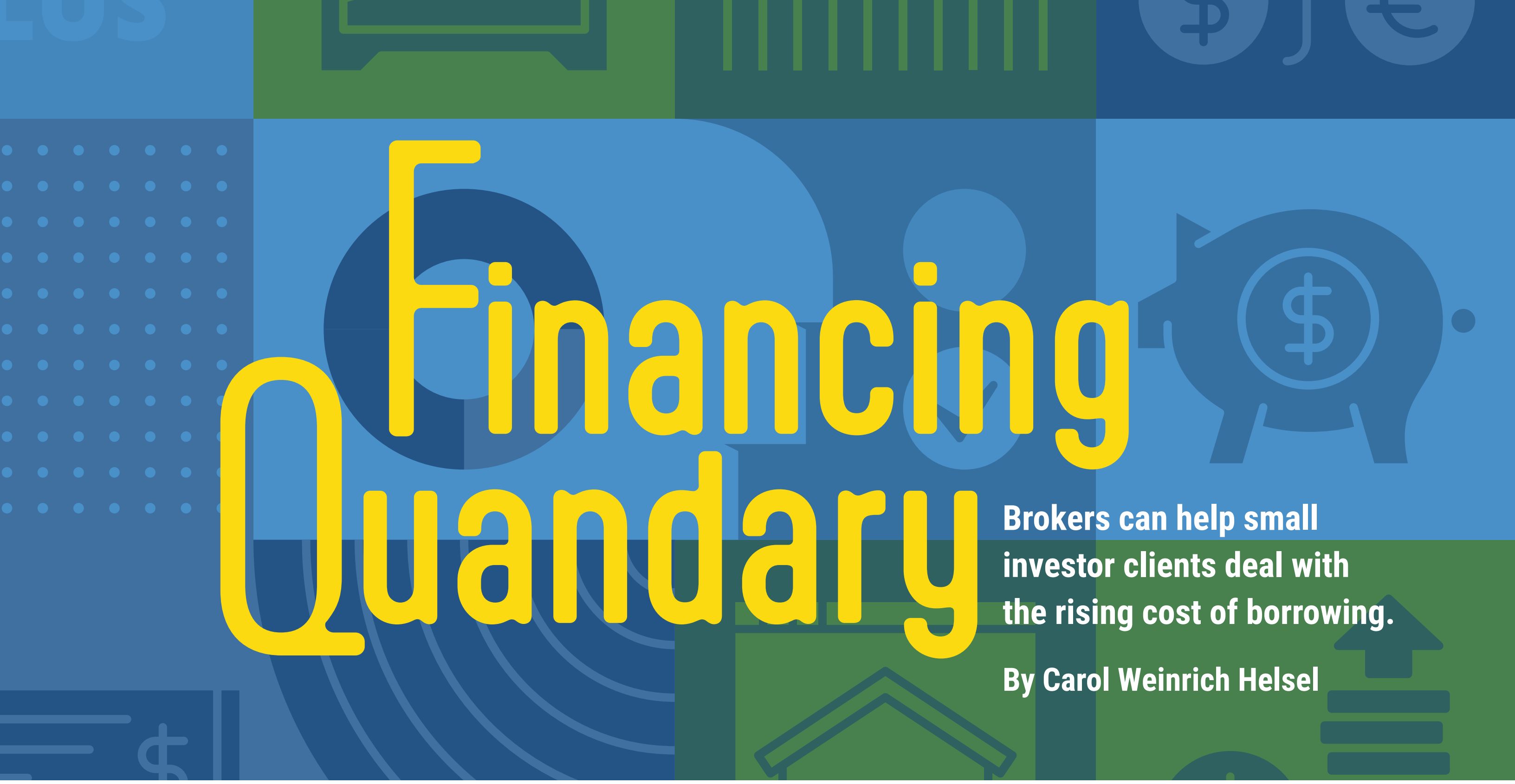
Getting to closing proved somewhat hair-raising, Cockerham says. "Guide Pointe didn't do their books in a conventional way that banks could underwrite." After going back and forth with a bank, "they had to redo their books, and it postponed closing by six months." As closing stretched from December 2022 to June 2023, Rivers Edge continued to bleed red ink, inching ever closer to the bottom of the reserves barrel.

Now that the deal is done, "Both of them feel really good financially," says Cockerham.

Takeaways: "I would never have guessed it would be a growing church trading with a shrinking church," Cockerham says. Though he used all the marketing tools at his disposal, it was simple signage and word of mouth that made it happen. "As much as we think about the internet these days, there's nothing like a sign sometimes to find the buyer.

"All deals seem to make sense eventually. As weird as they come together, in the end they make sense, and I couldn't imagine it any other way."

David A. Goldberg has written about transportation and urban planning for more than 20 years.



Financing Quandary

Brokers can help small investor clients deal with the rising cost of borrowing.

By Carol Weinrich Helsel

Many investors have hit the pause button for new commercial real estate projects. The increased cost of borrowing resulting from the steady rise in interest rates, combined with more conservative lending terms, has caused a significant drop in activity. In the last week of June, commercial and industrial loans fell by $7.9 billion to $2.75 trillion, after having peaked at $2.82 trillion in mid-March. Current owners, however, have little option but to face the challenges associated with refinancing loans coming due under less-than-favorable conditions.

To assist small- to mid-sized investor clients, consider these insights from brokers, investors and lenders on weathering today's commercial lending environment.

CRE Loan Snapshot

Analysis from Morgan Stanley Capital International found that nearly $900 billion in U.S. commercial property loans will mature in 2023 and 2024. MSCI analysts project almost $1.5 trillion of U.S. commercial real estate debt will come due before the end of 2025. In addition to higher borrowing costs, depending on the asset class, clients who hold these loans may also face lower valuations, softening rents, a smaller pool of lenders, tighter lending policies and increased scrutiny from risk-averse lenders concerned with balancing their loan portfolios.

"It's a tsunami for owners who are not on top of it," says John LeTourneau, CIPS, RENE, commercial managing director for Keller Williams in Naperville, Ill. "My team has been making the debt call for two-and-a-half years to let owners know their property will refinance in 'X' years and to expect their debt to be adjusted upward."

New investors may be shocked by the current lending environment, especially if they haven't raised rents. "The primary hurdle used to be loan-to-value ratio because debt was so inexpensive," says LeTourneau. "Now, it's the other way around—debt-service coverage ratio—and people will need to recapitalize."

"We keep our reserves on hand in case properties don't appraise at their previous debt-service coverage rate," says Michael Quigg, president of St. John Holdings Inc. in Radnor, Penn. "Right now, for office, it's a double whammy with occupancy down and rates up," says Quigg. "We're seeing loan rate numbers up 200 basis points from the original loan.

"There are product types we wouldn't look at right now—primarily office—because lenders are scared to make loans," Quigg adds. "We might find a nice property at a good price with long-term tenant leases but pass on it because of the difficulty of financing. Many tenants want to downsize, and banks are getting hammered by regulators for having too much office in their loan portfolio."

Inject Capital and Reduce Costs

Dawn Aspaas, broker-owner of Complete Real Estate in Sioux Falls, S.D., is advising her small investor clients to review their portfolios and identify potential weaknesses. "You need to be sure the portfolio is balanced, tenants are secure, and leases are locked in," says Aspaas. "Otherwise, you may find yourself upside-down."

Aspaas warns of rising utility costs such as water and sewer rates that catch building owners by surprise. While utilities typically rise with inflation, municipalities renewing contracts that have expired after three or more years are seeing double- and triple-digit increases in some instances.

When a property fails to appraise at the necessary debt-service coverage ratio, owners typically inject capital or work with the lender to restructure or write down the loan. Investors with a diverse portfolio are more likely to manage by moving projects and money around and, where possible, get the bank out of the picture, according to Aspaas. A small investor, however, has fewer good options.

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LeTourneau helps his clients prepare by identifying opportunities to increase revenue and, in his words, crush expenses. “There are many ways to make buildings more efficient,” he says, such as low-flow water fixtures and LED lighting. He also encourages owners to explore green incentives available through local utilities. Owners with just one or two properties can save costs by taking on basic maintenance or janitorial work.

Be Honest With Your Lender

Being transparent with the lender is critical in today’s market. “Lenders want that conversation,” says LeTourneau, “because they don’t want a negative asset on their book.”

Natalie Falatek, regional president of Mid Penn Bank in Harrisburg, Penn., agrees. “We want to know everything about a deal—warts and all,” says Falatek, who adds that it’s not uncommon for a loan application to get denied at the last minute in committee because someone found some obscure information online that wasn’t disclosed.

“The biggest lending challenge we’re seeing right now is that when you do a two- to three-year look back, you’re hitting the pandemic time where there was a hiccup in business financials,” she says. “The higher rates have severely impacted our smaller borrowers, but if they position things right, they can come out in a better financial position.”

Falatek says brokers can help clients by establishing relationships with banks to learn lenders’ appetites for various asset classes and find the right fit. “We encourage borrowers to establish a banking relationship and get to know us while we get to know them,” she says. “Knowing our customers and how they make money is the best way to counter uncertain economic conditions.”

With the number of troubled assets on the rise, borrowers and lenders are getting creative.

Fitting the Solution to the Loan

With the number of troubled assets on the rise, borrowers and lenders are getting creative. Banks use various strategies to help owners and investors restructure refinance in the current lending environment, including loan extensions, interest-only periods, bridge loans, U.S. Small Business Administration enhancement or guarantees (where qualified), A/B loan structures and swap programs to protect against fluctuations in interest rates.

Not all strategies are a good fit for all loan scenarios. Best-fit solutions vary depending on the circumstances and whether it is a recourse or a non-recourse loan, which allows a lender to seize only the collateral specified in the loan agreement, even if its value is insufficient to cover the debt. Some of these strategies are quite complex, and new or inexperienced borrowers can find themselves in a worse financial state if a lender approves a loan that, over the long term, isn’t a good fit.

Colleen Ensinger, senior vice president for Mid Penn Bank, advocates for community banks where borrowers and their broker can establish a personal relationship with their lender. “We look at both the customer and the transaction to determine the right loan structure,” she says, citing an example where a longer interest-only period might be right for owners who can’t raise rents immediately. “If they ask for something that’s not good for them, we’ll tell them. Big banks will support big customers, but, in my experience, smaller customers don’t get that level of service” from them.

When Banks Won’t Lend

As banks become more conservative in their lending, investors are turning elsewhere for sources of capital. “We would look at nonconventional lenders, such as a private credit company or a real estate hedge fund,” Quigg says. “They don’t operate under the same regulatory environment as banks. While their rates are likely higher than banks, they are an option if you can’t get a conventional load.”

Other bank alternatives include life insurance companies and private debt funds, also called credit funds or fixed-income funds, in which the core holdings are fixed-income assets. As banks pull back from lending, debt funds play a larger role.

Market Opportunities

Not everyone views the current market as a challenge. Buyers sitting on a lot of cash see it as an opportunity. “Speculative investors can come in and purchase properties from banks for pennies on the dollar,” says Aspaas. There are opportunities even for those without large cash reserves, including in the office sector, which is attracting the greatest scrutiny. “We always leave a little space in the office bucket,” Ensinger says. “For someone with good credit, we can look beyond just the numbers.”

In May, the Mortgage Bankers Association projected commercial and multifamily mortgage borrowing and lending to decline by $654 billion in 2023, a 20% drop from 2022, but to bounce back in 2024 to $829 billion. “We expect maturing loans to begin to break the logjam and provide greater clarity as this year goes on,” says Jamie Woodwell, head of commercial real estate research for the MBA. “However, it may take until 2025 for volumes to get back to previous years’ levels.”

In the meantime, brokers can continue to support their investor clients’ interests. Quigg looks for the broker to anticipate objections from lenders and have ready responses. “I understand the bank’s position,” Quigg says. “We look at the same factors lenders look at for a new investment, but a good broker can counter most objections.” ■

Carol Weinrich Helsel is owner of Pastiche Communications.

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TIGHTEN YOUR GRIP
ON OPERATING EXPENSES

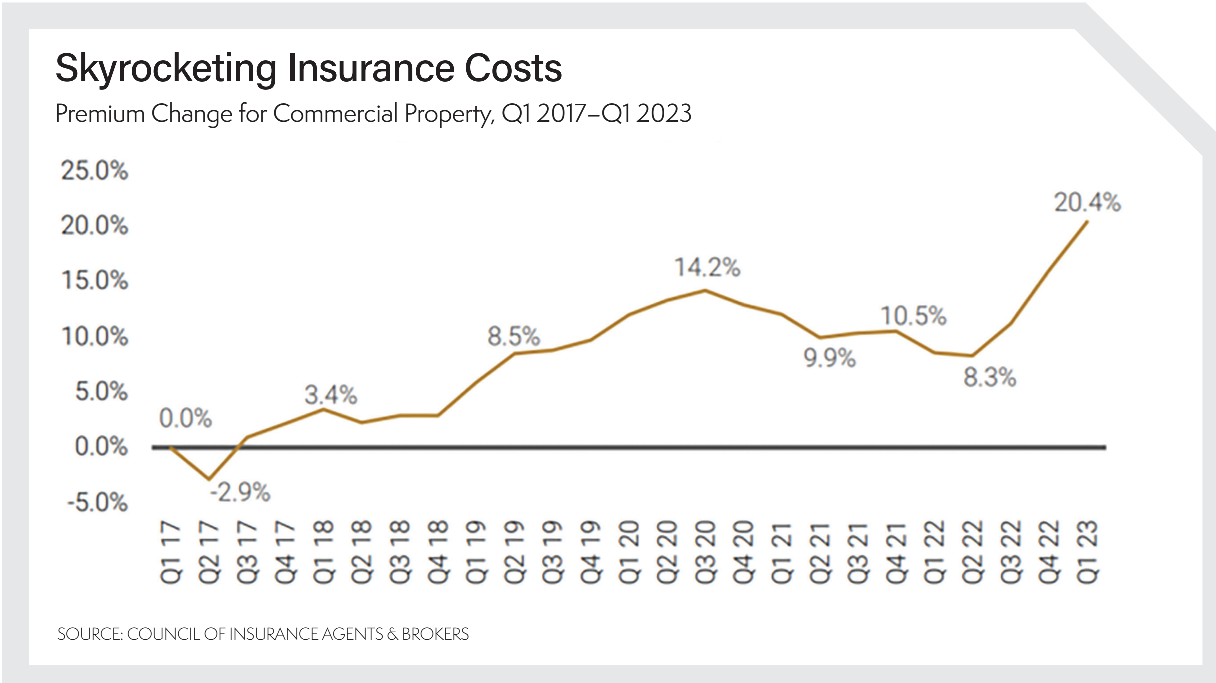
You may have more options to manage costs than you think.

BY LYNN ETTINGER

As a long-time resident of southern Louisiana, Matt Ritchie has seen extreme hurricane damage up close. But he never expected the financial wallop he took from a hurricane in 2020. A hotel he owned lost electricity for a day—not a huge deal, he says. But when the electricity and sump pump were restored, sewage backed up into 10 of the hotel's first-floor rooms. He immediately contacted his insurance company and was stunned to learn his policy didn't cover the damage. In another incident later that same year, at a multifamily complex Ritchie manages, a resident's pet bit another resident. The incident ended in a lawsuit against the complex. He contacted his insurer, who told him his policy didn't cover animal-related claims.

"I wouldn't have anticipated the two incidents that happened to me," says Ritchie, CCIM, president and broker at Ritchie Real Estate in Alexandria, La. "I couldn't have made it up."

The consequences mounted as his insurance costs rose 100% between 2021 and 2022 and 100% between 2022 and 2023, he says. His insurer changed his coverage from replacement value to actual cash value, and his deductible from $5,000 to $25,000. Those expenses took a toll on his operating costs, which spiked by 30%.



Today, stories like Ritchie's are not rare. On top of insurance increases, property managers are facing escalating property taxes, utilities and labor costs. As a result managers are closely monitoring costs, bidding out contract work and negotiating where possible to find savings.

Insurance Changes Are Off the Charts

Commercial property premiums in the first quarter of 2023 jumped an average of 20.4%, the first time an increase exceeded 20% since 2001, according to the Council of Insurance Agents & Brokers. *(See chart, "Skyrocketing Insurance Costs.")* That period also marked the 22nd straight quarter of overall premium increases, at 8.8%, according to *Insurance Journal.*

Ritchie's insurance brokers told him natural disasters are driving the increases, which are widespread. "Every part of the country has its own natural disaster—whether it's tornadoes or fires or something else," he says.

Sometimes a disaster can even affect insurance rates in a different location. "We're really feeling the pain from the spillover from the California wildfires and the fires in the Northwest," says O. Randall Woodbury, CPM, vice chairman of Woodbury Corp. in Salt Lake City. "To some extent, you get a surcharge if you're in a loss-heavy area. But even if you're not, you're paying part of the freight for losses wherever the trauma has been."

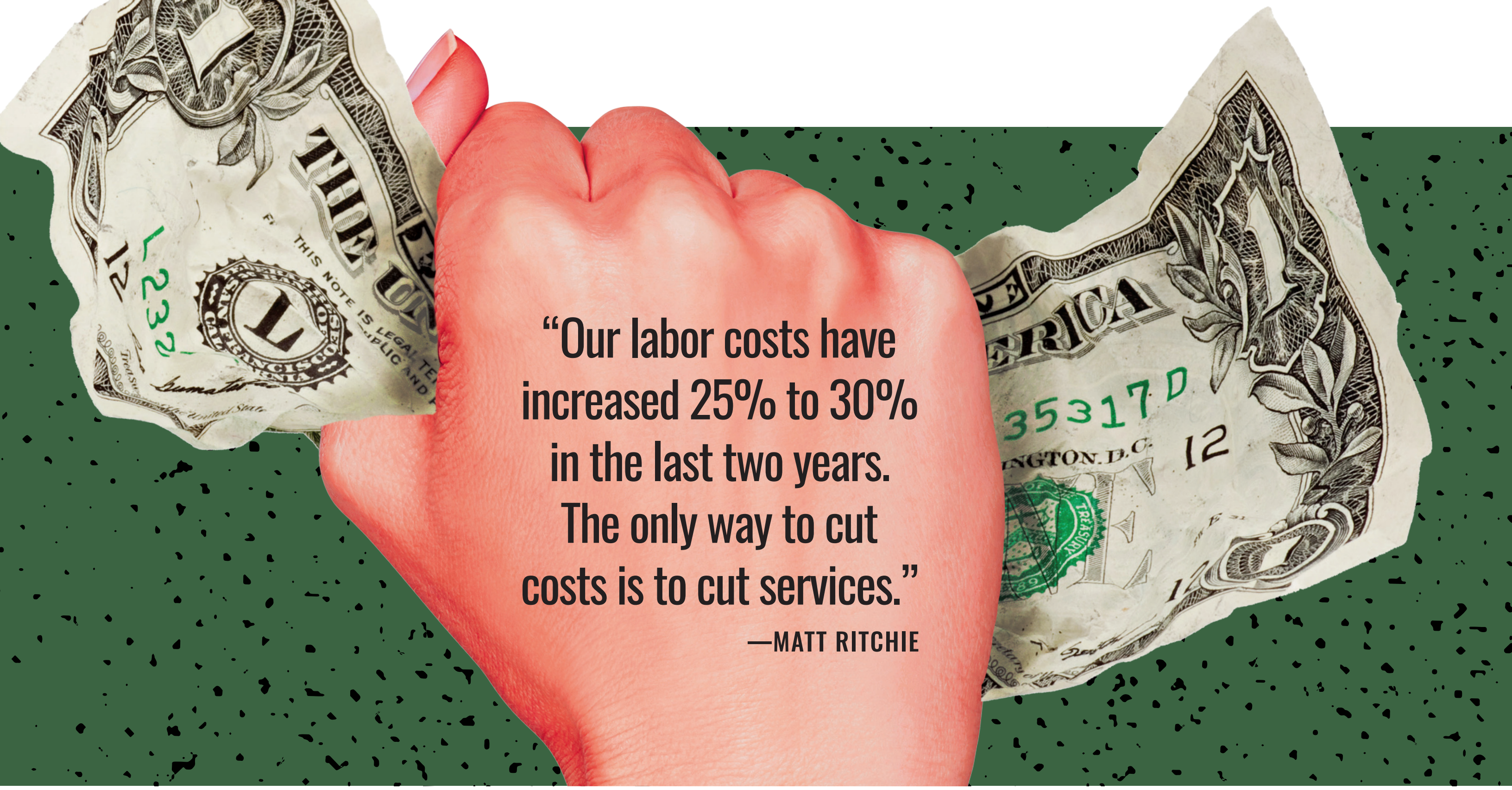
Commercial property managers are coping with broad insurance changes, including:

- **Exclusions:** "Read your exclusions in the policy," Ritchie says. "They're in fine print, usually on about the fourth or fifth page. I've learned you can try to negotiate those. If you say, 'I want coverage for this particular issue,' [the insurer] may create a premium that you pay for."
- **Declining competition:** Insurers are pulling out of some states, including Louisiana, limiting competition and enabling those that stay to hike their rates, Ritchie says. In a tough insurance market like this one, options that might not have been on the table now include catastrophic coverage with a very high deductible or, if a mortgage isn't involved, self-insurance, he adds.
- **Higher premiums, deductibles and risk:** "It's not just that the coverages are being watered down, but we're finding the only way to keep premiums in check is to absorb more of the risk," says Woodbury. "Some negotiations have been, 'Oh, my gosh. You're asking for this increase? How much would you trim that if we agree to pay a higher deductible?'"
- **Lender requirements:** "Lenders are paying a lot more attention to the coverage you have and the types of coverages that are on their shopping list of coverage you have to carry," Woodbury says.

Scrutinize Property Tax Assessments

Property tax is another rising cost, says Woodbury, whose company operates in 16 states.

"You have to be vigilant about how your property is being assessed compared to comparable properties. We're going to be looking really hard at assessments on any office buildings this next year. We know there's going to be a huge drop in values, so we've got to stay on top of whether the counties are acknowledging that."



Ritchie suggests filing a tax appeal based on new net operating income. Explain that revenues are down, operating expenses are up, and the building doesn't generate the net operating income it used to. Therefore, the property is really actually worth a new, lower amount.

Utilities Power Up Increases

"Utilities absolutely are a pain point," Ritchie says. He suggests making changes on the properties to help over the long term, such as converting lighting fixtures to LEDs, using more energy-efficient HVAC systems and conserving water. "Consume less and you'll pay less," he says. "You can let tenants know you're going to run the utilities at 70 degrees from 8 a.m. sharp to 5 p.m. sharp. Tell them, 'If you stay after, we're going to bill you back.'"

Work to Reduce Labor Costs

Service companies, such as janitorial and landscaping businesses, are fighting to get and keep good people by paying them more, Woodbury says. "And those increases in labor costs trickle through."

"Our labor costs have increased 25% to 30% in the last two years," says Ritchie. "The only way to cut costs is to cut services. For janitorial services, instead of doing five days a week, we may be doing three."

Will Curtis, CCIM, CPM, commercial managing director at Phyllis Browning Co. in San Antonio, has reduced labor costs by hiring an employee with a specific skill set. "[The employee] was licensed and savvy on HVAC and could do a lot of the work. We brought him in-house, and it saved us a significant amount of work on HVAC repairs because we didn't have to go out to that third-party contractor."

More Solutions to Manage Operating Costs

Property managers can use options like these on an ongoing basis:

- **Rebid services regularly:** "Nobody wants to re-shop every service and rebid it every year," Woodbury says. "And there's value in long-term relationships with your service providers. At the same time, you can be asleep at the switch about a contract price being too high. One area to watch for is trash removal."
- **Focus on sustainability and upgrades:** Curtis advocates sustainability. "You can add it with initial repairs and maintenance that are coming through or invest in something that will pay off over time. You could have a leaky flush valve on a toilet, and instead of going back to what you had, choose something that uses less water."
- **Survey tenants about amenities:** Ritchie recommends surveying tenants to find out which amenities they value. "The property manager can tell the tenant, 'I can either pass the cost for this through to you, or we can cut it out. What's more important to you?' If the majority of the building doesn't care or want to pay for it, why pay for it?"

When managing operating costs, be vigilant. Have discussions with service providers, property insurers and property tax assessors. Woodbury advises, "Look for ways you can streamline or change something about the service to get more value from the dollar." ■

Lynn Ettinger is a Chicago-based business writer.

Attracting Foreign Investment

Despite challenges, the U.S. presents favorable conditions for global investors. **BY ALEX RUGGIERI**

For the first time in 25 years, FIABCI (the International Real Estate Federation, known by its French acronym) held its annual World Real Estate Congress in the U.S. The event, held in Miami in June, attracted attendees from more than 30 countries and was a positive sign for commercial pros who work with foreign buyers.

The U.S. remains fertile territory for investing, says Gunnar Branson, CEO of AFIRE, an association for international investors in U.S. commercial real estate. "There are about 30 or 40 cities that are considered global real estate markets. China has two or three. The United States has more like 12," Branson says. Despite headwinds caused by rising interest rates, respondents to an AFIRE survey released last March said they planned to increase their investment in U.S. real estate in 2023 compared with 2022. What factors continue to draw foreign money?

Pro-growth Agenda. The U.S. has a transparent business environment, strong legal framework and favorable investment climate.

Economic Stability. The robust regulatory framework, strong institutions, and well-developed financial system provide confidence to foreign investors by minimizing the risks associated with economic fluctuations.

Property Rights. Investors have confidence that their investments will be safeguarded and that they can enforce their rights through the court system if necessary.

Diversification. By allocating their investments across different countries and asset classes, investors can mitigate risks and potentially increase profits.

Political Stability. The U.S. has a traditionally stable political environment and strong rule of law, which are attractive to foreign investors seeking a safe and predictable investment.

Potential for Appreciation. U.S. real estate has historically demonstrated long-term appreciation in value. Many foreign investors see the U.S. market as an opportunity to generate capital gains over time, especially in prime locations such as in major cities and popular tourist destinations.

Transparency and Market Liquidity. Investors can easily access information about market trends, property values and rental rates, enabling them to make informed investment decisions. Additionally, the market offers a wide range of investment opportunities, including residential properties, commercial real estate, and real estate investment trusts.

Exchange Rates. Fluctuations in exchange rates can create opportunities for foreign investors to capitalize on favorable currency conversions. If a foreign investor's home currency strengthens against the U.S. dollar, their real estate investments can yield higher returns when repatriated.

Education and Lifestyle. The U.S. is home to many prestigious universities and educational institutions. Some investors see the potential of investing in real estate near these institutions, offering rental properties to students or catering to the needs of the academic community.

Tax Benefits. The U.S. tax system provides certain advantages, such as deductions for mortgage interest, property taxes and depreciation, that can enhance the overall return on investment for foreign investors. Bilateral investment treaties and tax treaties with many countries provide a framework for protecting investments and avoiding double taxation.

Despite their bullishness on the U.S. market, foreign investors face a range of challenges, including the need for regulatory compliance, cultural differences and market competition. Nearly all respondents to the AFIRE survey said continued interest rate increases were impeding transactions.

Overall, though, the combination of innovation, access to capital, and economic and political stability, along with a favorable tax and regulatory environment, make the U.S. an appealing destination to seek growth and profit. And the benefits of foreign investment swing both ways, Branson says. "It's nothing but positive to have outside investors who believe in the future of your country."

Alex Ruggieri, CCIM, CIPS, CRE, is a senior investment advisor with SVN-Northstar Real Estate in Champaign, Ill.

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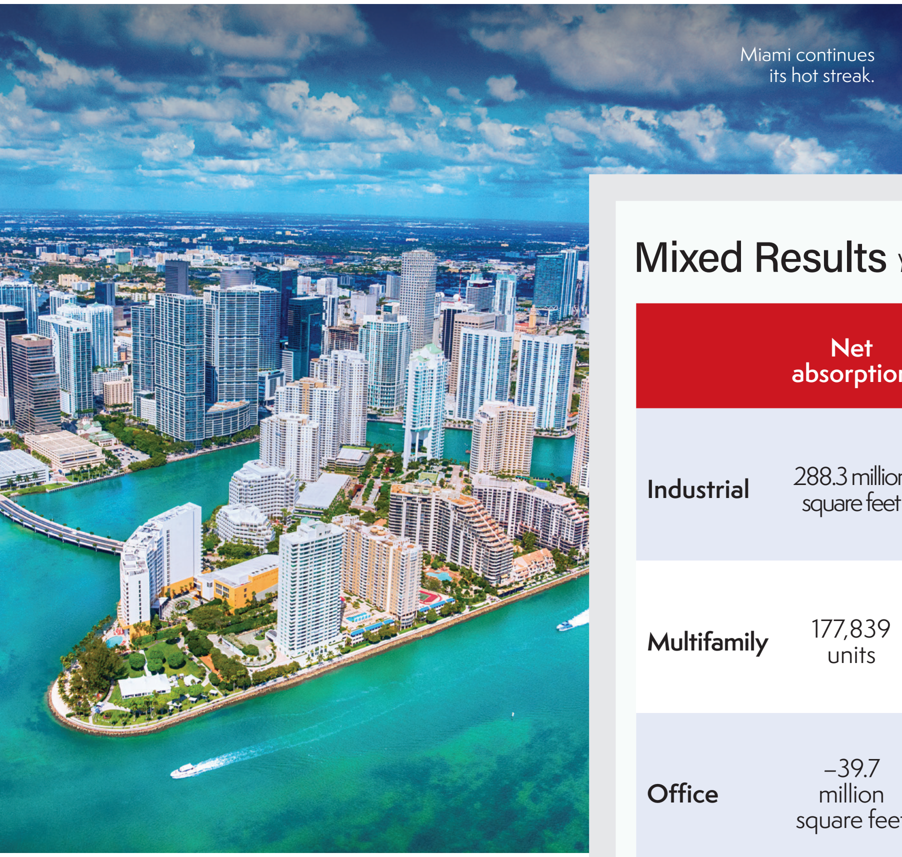

Miami continues its hot streak.

Not a Bad Picture

With long-term interest rates returning to normal, real estate opportunities abound.

BY LAWRENCE YUN

Mixed Results *Year-over-year data as of June 2023*

	Net absorption	Rent growth	Vacancy rate	Cap rate	Hot markets
Industrial	288.3 million square feet	8.86%	4.72%	6.53%	Dallas–Fort Worth, Miami
Multifamily	177,839 units	1.15%	6.89%	5.99%	New York, Chicago
Office	–39.7 million square feet	0.77%	13.1%	7.27%	Miami, Dallas–Fort Worth
Retail	54.5 million square feet	3.62%	4.19%	6.29%	Phoenix, Austin

SOURCE: NAR ANALYSIS OF COSTAR DATA

While Americans await the Federal Reserve's next decision on its short-term funds rate, the long-term interest rates, including the key 10-year Treasury borrowing rate and most rates on commercial real estate loans, appear to have already topped out. The reason: Consumer price inflation has largely calmed, recording only a 3% rise in June. Further deceleration of inflation is assured as housing rent growth also calms down from the still-hot 8% rise to a much softer level, given the 40-year high in apartment construction.

Meanwhile, warehouse construction was up 4% to account for online shopping growth, which is still outpacing retail in-store shopping following the pandemic. Online sales rose by 7%, while retail sales chugged along at 4% growth, after excluding falling sales at gas stations.

Four million more Americans are now working compared to pre-pandemic March 2020, leading to positive spending activity. Even with the increase in work-from-home and office vacancy rates, the dollar value of office completions rose by 6%, as decisions to start construction no doubt took place before the pandemic. Due to excess inventory, office property prices have been falling, presenting a big challenge but also an immense opportunity for agents and brokers. ■

Lawrence Yun is chief economist and senior vice president of research for the National Association of REALTORS®.

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The Latest

NAR's monthly Commercial Market Insights and quarterly Commercial Real Estate Metro Market reports analyze the fundamentals and direction of the commercial real estate market and provide a deep dive into the nation's 175 largest metropolitan commercial real estate markets.

Commercial Market Insights: nar.realtor/commercial-market-insights

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U.S. Rep. Jahana Hayes of Connecticut greets constituents at the REALTOR® National Block Party.

PRESIDENT'S MESSAGE

YOUR ADVOCATE

In May, 11,000 REALTORS® joined members of Congress at Nationals Park in Washington, D.C., for the REALTOR® National Block Party. It was a good time, but more importantly, it sent a strong message about the energy we put into building relationships in Washington. That's been critical to our success on a range of issues, from preserving the 1031 exchange to fighting regulatory overreach on evictions and land use. Commercial real estate requires an analytical mind, creativity, patience, product knowledge, an understanding of your client's business, and the ability to shift strategies with changing market conditions—and it deserves an association that supports your success. That's exactly what the National Association of REALTORS® does, not only through our advocacy but also through education, networking opportunities, discounts on essential tools and exclusive access to RPR Commercial. See for yourself at the C5 + CCIM Global Summit (c5summit.realestate), Sept. 28–30, and at NAR NXT (narnext.realtor), Nov. 14–16.
–Tracy Kasper

Survey: Americans Prefer Walkable Communities

BY LAUREN E. PINCH

Americans living in walkable communities report a higher quality of life, according to the National Association of REALTORS® 2023 Community and Transportation Preferences Survey, gauging what community attributes people find most desirable within America's 50 largest metropolitan areas.

Commercial practitioners may find the survey offers useful data points for retailers or other businesses seeking the right location.

NAR has conducted community preferences surveys for more than 20 years, providing NAR members and their communities with valuable information on shifting American lifestyles and migration trends.

Among noteworthy findings of the survey:

- 79% said being within an easy walk of other places and amenities, such as shops and parks, is very or somewhat important when deciding where to live. Of these respondents, 78% indicated they would be willing to pay more to live in a walkable community.
- 85% said sidewalks and places to walk are very or somewhat important.
- 65% said having public transportation nearby is very or somewhat important.
- 56% said they would prefer a house with a small yard where they were able to walk to places, compared to 44% who would prefer a large yard where they would need to drive to most places.
- Generation plays an important role: Asked about their preferred community, Gen Zers and millennials are more likely to prefer an apartment or townhouse with walkability and a short commute. Gen Xers and Boomers are more likely to lean toward a detached single-family home and longer commute.

nar.realtor/community-and-transportation-preference-surveys

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Give Investor-Sellers a Reason to Choose a First-Time Buyer

Congress can help level the field by passing tax incentives for landlords selling single-family homes.

BY EVAN LIDDIARD

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If you work with investor clients who purchase single-family properties as investments, consider getting behind a proposal that will incentivize them to sell homes to first-time buyers. Here's why.

It has never been easy for most would-be buyers to achieve homeownership. Setting aside significant funds for a down payment can take years of patience, sacrifice and discipline. Over the last few years, the down payment challenge for many has been overshadowed by another, often more formidable problem: bidding wars.

Even before COVID-19 changed most aspects of our lives, the inventory of starter homes for sale was tightening. And now, even with interest rates well above the trough of December 2020, bidders can find themselves in competition not only with other first-time buyers, but with cash-paying investors who are adding to their stock of single-family home rentals. The disheartening reality is that the odds are stacked against many people trying to buy their initial home.

Economists with the National Association of REALTORS® estimate that about 2.5 million households shopping for a first home were shut out of the market last year.

The underlying problem, of course, is that America is woefully undersupplied with adequate housing. A 2021 study by the Rosen Consulting Group concluded that due to underbuilding over the past two decades, the U.S. is short by more than 5.5 million homes. The study further found, in order to fill this gap, it would take a 60% increase in construction per year for at least a decade.

The obvious answer to this gargantuan challenge is to change federal, state, and local policies to encourage more home building of all kinds and in all ways, and to be patient, because this problem is going to be with us for a long time.

Reduce Capital Gains Tax for Rental Home Sellers

However, by creating immediate tax incentives for sellers, Congress can help level the playing field between first-time buyers and those who are purchasing single-family homes as investors.

In 2019, NAR adopted policy to support legislation that would offer sellers of single-family rental homes a reduced tax rate on capital gains when the purchaser of the property is a first-time buyer who will occupy the residence as an owner. This simple incentive could be a game-changer for hundreds of thousands because many investors in rental homes have substantial equity and would face significant capital gains taxes if they were to sell.

The bids of those who are seeking their first home would immediately become more attractive to sellers because the after-tax return of the seller would jump markedly.

A 2023 study by economists Andrew Hanson and Ike Brannon found that a 50% reduction in the capital gains tax rate for small investor-owners that sell a property to a first-time buyer would increase single-family home supply by between 67,000 and 146,000 homes. And extending the policy to all but the largest institutional investors could roughly double these numbers, making a significant impact on the supply of starter homes.

The current tax law favors investors over owner-occupiers. While some higher-income home owners can still get tax advantages through the mortgage interest and property tax deductions, they must itemize to gain these. Only about one in 10 tax filers itemize their returns today. Investors, however, are able to fully deduct all interest and tax and other expenses of their rental home.

Making this simple tax policy change would give the American dream of homeownership a fairer shake by leveling the field for those who have sacrificed to buy a home but can't compete in today's market. ■

Evan Liddiard, CPA, is director of federal tax policy for NAR.

BKV GROUP

LOFTY AMBITIONS
The Duffey encompasses three side-by-side buildings filling an entire city block of the Warehouse District: the Minneapolis Iron Store buildings built in 1916 and the Lindsay Brothers Warehouse built in 1910.

Twin Cities Twist

Conversion of Duffey Lofts in Minneapolis demanded several surprise solutions.

BY JEFFREY STEELE

For many urban dwellers, there's nothing more appealing than living within a character-rich vintage building in an historic district. This demand alone should have ensured the conversion of C.J. Duffey Paper Co. warehouse in Minneapolis into a multifamily property more than a decade ago. But a full 15 years after the historic building was last occupied by its former owners, it still had not attracted a redeveloper.

It took Chicago-based CEDARst, teaming with architectural firm BKV Group of Chicago and RJM Construction of Golden Valley, Minn., to tackle the building's innate obstacles and emerge with a triumphant redevelopment.

The team addressed the warehouse's very large building floor plates by creating a central atrium that could flood the interior with natural light and provide inward-facing residences with outdoor views. The inclusion of a Deltabeam slim floor allowed for the addition of one more floor. By preserving the existing structures, the team was able to avoid the heavy environmental toll of new construction.

The result: The Duffey, a 188-unit multifamily property featuring 93 studio units, 85 one-bedroom apartments and 10 two-bedroom apartments. Features and finishes of residences include stainless steel appliances, ceramic hexagonal mosaic floor tiles, hardwood floors, rainfall shower heads, and white and gray quartz countertops.

The project broke ground in August 2020 and opened in spring of last year. A second phase is scheduled to finish by the end of this year.

THE DETAILS

- Located in the coveted Warehouse District
- Project cost $71.1 million and benefited from funding that included Minnesota state historic tax credits
- Project size 92,109 square feet, including 24,000 square feet of retail and 10,300 square feet of common area amenities
- Light well measuring 30 feet square carved into interior for natural light
- Subterranean parking structure providing approximately 100 vehicle spaces, with another 32 spaces outside
- Features including a sun-washed, double-height resident coworking space and coffee shop; a full-sized fitness center; and atop the building a timber-exposed club room, lawn and lounge area

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