BROKERS THINK OUTSIDE THE BOX

By John Salustri

The general consensus among commercial real estate professionals is that the economy has peaked—or, at the very least, has slowed its record roll. Now, before you go running to your bank with thoughts of stuffing your capital in your mattress, there's a big difference between "passing peak" and "plummeting prices;" the same consensus dictates that the record-setting upcycle still has room to run.

All that said, investors are holding their water a bit longer to find deals that are closer to a slam dunk, which has major implications for leasing and investment brokers. "Success in today's market means thinking outside the box," says Mark Kolsrud, SIOR, Minneapolis-based senior vice president of Colliers International. "For investors, that might mean looking at product you might not have looked at before. It might mean looking at it in a new and different way, at the trajectory of income in a way that your competition isn't seeing."

That new way of approaching transactions is a lesson for investors best taught by their brokers, as Brad Kitchen, SIOR, president of Alterra Real Estate Advisors in Columbus, Ohio, explains. "The first step is to take into account the comfort level and the risk-tolerance of the client," he says. Within those hard-and-fast guidelines, "we have to get creative sometimes to make a deal work."

"We've represented investors whose price range made finding properties a challenge," Kitchen continues. "If they'd expand that range by a few million dollars, we could find something that would fit their requirements." It's not a scenario that commonly flies, so that's when the creative juices have to start flowing.

"Sometimes you have to structure the deal to make it work with the equity the buyer has available to them," he says, "either through some seller financing or through a structured or mezzanine-debt scenario." Introducing the client to the possibility of partnering in a syndication is another option for accomplishing their investment goals.

Jeff Castell, SIOR, executive director of Cushman & Wakefield in Indianapolis, agrees with the importance of focusing on client need. "It all starts with understanding the client's investment objectives," he says. "You certainly can't take a one-size-fits-all approach. Once we have the deep understanding of the client's investment objectives, we can produce a customized strategy based on the belief that every asset or group of assets is unique."

Therefore, he continues, a customized plan has to fold in such specific considerations as "market conditions, capital flows, and local intelligence, and then that needs to be balanced against emerging trends." The result, he says, is a holistic approach tailored to the client and the need at hand.

He provides the example of an offshore client of the firm planning a cold-storage facility in the East Indianapolis industrial submarket. A colleague called Castell and told him that the CFO was "getting ready to develop a 430,000-square-foot cold-storage distribution center on 45 acres. He said they had a third-party provider who had offered to build and operate it for them and charge them rent established by a yield of X on the cost, and they wanted to know if that made sense."

The answer, he said, was no. In fact, the price was at a significant premium to where they should be, given local market conditions. "We told them that if they could afford us a little flexibility, they could construct this facility themselves, and we could sell it in the market at cost to an investor willing to accept the lowest return," he explains. The result was a savings of "tens of millions of dollars," Castell says.

"The CFO allowed us to educate them on current market trends," he explains, "including the current, voracious appetite for long-term net-lease assets and the abundance of capital in the market. So we were able to drive the yield down about 350 basis points below where he was originally quoted."

Similarly, one of Kitchen's recent transactions began with a seller focused on an inflated number. He cites a recent warehouse sale in which the seller had his eye on a certain price "much higher than the rent justified. So, we had to create a structure that enabled the seller to get their price, the buyer to achieve their return, and make it financeable. We ended up doing a master lease with a prepaid component and a lease modification to make it work better for the buyer, and so the seller could get his higher price."

For Kolsrud, a sample of out-of-the-box thinking comes in the form a new twist on the tried-and-true SIOR practice of partnering up. "A broker friend of mine [Gerry Norton, SIOR] had a relationship in a Central Iowa building," he relates. "The owner/user wanted to monetize the asset and was looking for an investor, so they reached out to me."

The colleague is primarily a leasing broker, while Kolsrud and his six-person team are investment sales specialists. "We collaborated and received 12 offers," he says, ultimately choosing an institutional capital group "that otherwise wouldn't have found that transaction." This means that the seller wouldn't have found that buyer, "and we would have left money on the table if we had only limited ourselves to the local market." The 411,294 square foot industrial asset went for just over $21 million.

Sound self-evident? Such nuances make the difference between success and failure, says Kolsrud, especially as the market rolls into its late-stage cycle. "We're probably post-peak now in some markets," he says. "We're not in a freefall, but we are seeing some diminishing interest in certain product types, especially assets like suburban office with no amenities." In such cases, he says, even in properties with a solid tenancy, "we're still seeing cap rates rising 200 bps."

You can add some growing hesitation on the part of lenders who "aren't as willing to loan as aggressively for certain product types," he says. "And, of course, the interest-rate environment has taken some of the shine off cap rates generally."

Kitchen agrees. "Investors are scrutinizing deals a little more closely," he says, "because we've been in such a long expansion cycle, and they don't want to get caught in a slowdown now. So they might be thinking twice about taking quite as much risk as they might have over the past three or four years."

He adds another reality of this late-stage scenario: inventory: "There seems to be fewer products to buy at a reasonable price. So you do have to get a little more creative to either find more properties or appropriately structure the ones that you're working on, due to the lack of supply."

Yes, says Castell, there's tighter inventory, but he's not buying into the thought that an economic downturn is driving the need for more creativity in client relations. "Market participants, prognosticators, and pundits seem to agree that we're late in the cycle," he says. "Nevertheless, demand characteristics have created a supply shortage or imbalance, and we're projecting that industrial rent growth in 2019 will be something on the order of 4.5 percent.

"So while we may well be late-cycle," he continues, "there are other characteristics that influence market activity. I'd suggest that creative approaches to our clients' needs are applicable irrespective of the market or cycle we're in. Markets are always consistently competitive, and everyone is looking for that edge."

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No matter what happens with the upcycle over the coming year, the ability to get creative in shaping deals is a major competitive advantage. “Rather than simply saying, ‘we can’t find anything that suits your needs,’” says Kitchen, “we’d rather say, ‘Let’s try to figure out a way to get this done.’”

Differentiating yourself through partnerships with SIOR members beyond your sphere of expertise “makes a huge difference,” says Kolsrud. “I’ve found a great deal of success teaming with local experts and combining our different expertise to different markets, especially today when so much more institutional money is used pursuing small-market and smaller credit type transactions. But they don’t have the resources to go to every market and develop relationships with every broker and understand every tenant. That’s a perfect scenario for two SIOR partners to share their expertise.”

And then to serve, as Castell concludes, “as educators.”

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GEODATA AND COMMERCIAL REAL ESTATE

Written By: Jim Klein, SIOR

WHAT IT IS

While not its own product, geodata is widely used in many commercial internet applications like Yelp, Google Maps, Twitter, Foursquare, and Factual. These web services use geodata to match your phone’s location to their own mapping programs. This same relationship between geodata and the connected internet may enhance your own real estate business.

HOW IT WORKS

For CRE applications, in the field, it’s routine to take pictures of different properties that create a trail of images on the exact route the pictures were taken. One basic use is to create a map of property which uses point data to link to other property details. Location is an intuitive way to organize real estate data. Instead of presenting property in a spreadsheet or tabular format, I often give the customer a map so they can click through to the various points.

Geodata comes with many mathematical functions—the most familiar is radius search. For any listing you are marketing, it’s easy to record all your tenant data using GPS. This allows you to target a market based on various distances from your listing and focus on those tenants closest to the property. Thasos is a data company that uses location to enhance hedge fund knowledge. One of their popular applications is to use geofencing to predict shopping mall traffic. Similar point data is used to measure truck traffic to find the busiest freight nodes to evaluate warehouse locations.

WHY USE IT

For SIORS, once you link point data to your Customer Relationship Manager (CRM), you can visualize other data sets like size, SIC, and vacancies. The most value comes from using location data to find deals. When a mobile GPS application is linked to your database, you can take a picture and the coordinates will seamlessly connect to your data, saving the time to record, search, and communicate. Geodata is an underappreciated real estate tool because it takes a small amount of technical expertise to master. Location data is a free and ubiquitous protocol that works perfectly with property. Mobile applications allow you to be in the field and serve up real time location data to make more deals. Because of the ease in matching mobile images to maps, more innovative programs are being developed to archive, present and transact using geodata.