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COMMERCIAL LEASE NEWSLETTERS

This month's newsletter will focus on a problem facing many of our commercial landlords and commercial property managers: The looming commercial real estate foreclosure problem facing Florida and national commercial real estate. This issue will dwarf problems with commercial leases. The potential crisis should also give commercial landlords and property managers' incentive to retain tenants, provide tenant inducements, and take all steps necessary to maximize their net operating income to enhance their properties for future refinance or loan modifications.

COMMERCIAL REAL ESTATE FORECLOSURES—THE NEXT BIG CRISIS AND THE SUGGESTED SOLUTION

Like a punch drunk fighter with a big heart grappling to get up off the canvas after a one two punch of devastating residential foreclosures and skyrocketing unemployment rates, our real estate economy is staggering to its feet. Unfortunately we may be facing a knockout punch due to a potential crisis in commercial real estate. Proactive ways exist to avert the next blow, but it will take intelligence and bold planning.

Here are some causes for concern:

1. Commercial vacancy rates have risen sharply in the last several years, reflective of the downturn in the economy and overbuilding of commercial space.
2. As vacancies increase, values of commercial properties drop.
3. As vacancies increase, commercial property owners struggle to service mortgage debt creating default scenarios.
4. When defaults occur in commercial loans, foreclosures result and values drop further.
5. Because of the tight credit market a significant number of commercial loans that originated between 2004 and 2008 will be precluded from refinance opportunities.
6. Even solvent borrowers are being denied extensions of their loans due to current low appraisals on commercial property.
7. Between 2009 and 2011, over $814 Billion in commercial real estate loans will mature nationally.

8. Deutsche Bank has issued a report indicating that 80% of the commercial loans made in 2007, financed by mortgage-backed securities, and due to mature but will not qualify for long term financing. If not extended they will go into default.

This is a crisis that will be upon us very soon. Our institutions and our government cannot react as inefficiently as they have in addressing residential foreclosures. Florida should also not pin its economic "Hope" on the federal government providing our state a bailout. One would have assumed that with Florida being the hardest hit economy of all fifty states due to the economic downturn, that the Federal Government would have designated Florida as one of the top states to receive Federal stimulus money and assistance. Shockingly, Florida is fiftieth (50^{th}) in per capita receipt of Federal assistance. We need to address this problem without looking for "bailout money" or corporate welfare.

Here are my suggestions to address the problem:

1. **Tax Subsidies For Private Investors vs. Bank Bailouts.** Encourage the purchase of commercial mortgage paper and properties by offering tax subsidies. Private investors taking over troubled properties or nonperforming loans will request a discount for the risk assumed. This causes write-downs by lenders who may seek additional governmental bailouts or face FDIC takeover. A better solution is to provide tax subsidies for these investors to increase their return on investment, correspondingly enhancing the asset value of the loan or property to be acquired, which itself ultimately reduces loan loss due to a reduction in the write down on the troubled asset.

2. **Smart Business Model Based Government Guarantees.** Rather than bailout lenders from toxic commercial loans the government should conduct itself as a sound business manager for its shareholders—the U.S. Taxpayers:

   A. Identifying non-toxic commercial assets.

      Provide a federal guarantee for only a portion of the loan based upon an economic analysis of anticipated revenues. This calculated government guarantee would encourage lending by banks to refinance or modify performing but struggling loans.

   B. Identifying toxic debts held by lenders.

      Let the market dictate the disposal of these toxic debts with tax subsidies for investors to encourage the purchase and enhance the value of the troubled asset to reduce the loan loss. If the asset is truly toxic, then let the bank suffer the loss and allow the marketplace to correct itself, which if necessary, means that institution suffers the loss for their poor lending practices.

C. Using government guarantees.

   This incentivizes banks to modify existing loans but provide for a recapture value so taxpayers share in profits when the loan performs.

D. Restricting the amount of government funds that guarantee the new "Public Private Investment Partnership".

   The PPIP was formed to assist banks in disposing of their toxic debt (now euphemistically referred to as "legacy assets"). However, one of the key flaws in the government's PPIP program is that it requires the Treasury to back up the private investors with over 85% financing on a non-recourse basis with a poor return to the U.S. taxpayers. Even more compelling an argument against this program is that it is limited to an exclusive group of companies. In reality only the eight largest hedge funds on Wall Street can participate and make profits in the PPIP program.

3. **21st Century Mediation Model.** More efficient ways exit to address commercial loan defaults than the antiquated foreclosure process currently in use. Lending institutions need to embrace proactive mediation, proven to effectively resolve issues in Florida litigation cases with a success rate of over 80%. Lenders need to staff their loss mitigation departments with solution-minded individuals tasked to structure creative loan workouts that include the use of government guarantees, tax subsidies and other innovative loan workout approaches developed by lenders. Use foreclosure suits only as a last resort to a loan that cannot be otherwise modified, restructured, sold or mitigated to reduce or eliminate the loss.

The next real estate crisis will soon be upon us. We need leaders who can assess the risk and implement a sound business approach to resolve the problem while exercising their fiduciary duties as stewards of the taxpayer's money.

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