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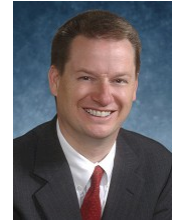
Following is the second in a series of newsletters designed to foster a healthy dialog. I hope you enjoy it and encourage your feedback and discussion. The full piece is available on the web at:

<http://www.caswell.org/newsletters/20090428page1.asp>

Please drop me a line and let me know your thoughts: [ward@caswell.org](mailto:ward@caswell.org)

Regards,

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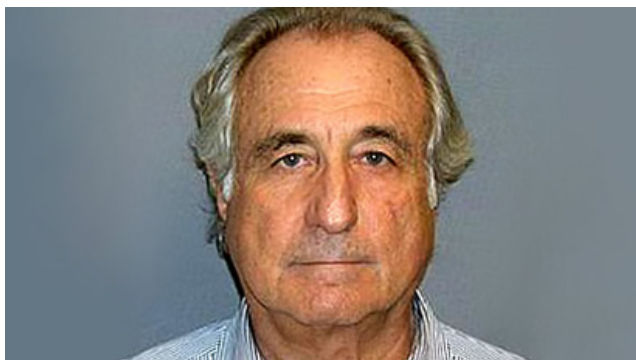
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## Smart Decision Making in Tough Times

Its springtime in New England and signs of emerging life are everywhere. Tree branch tips are bright red in the morning sun and bulbs have pushed their green shoots from cool ground. The daffodils are blooming and the crocuses have already passed their prime. Still, it was just above freezing last week and the squirrels are looking pretty thin after a long cold dark winter. The analogies for the economy are striking. The stock market rallied, financial institutions reported unexpected profits, consumer confidence improved, and other leading indicators rose. Still, we are a long way from full recovery. Clearly there is much to be hopeful about even as institutions continue to shed jobs or fail. Good farmers know the right time to plow and plant. So too must the good manager know when to make changes in their business.



Stock analysts point to price earnings ratios and healthy balance sheets of many firms to try to reason that the bottom has been hit. I suggest that the turn in the markets derives more from the attitudes of the masses and their need for a feeling that something has changed to make markets more trustworthy. There is a cry for justice and punishment. On March 9<sup>th</sup>, 2009 the Dow Jones Industrial dropped to 6547, a level not seen since the end of 1996. On March 12<sup>th</sup> Bernie Madoff pled guilty to 11 felony charges. Images of Madoff in handcuffs filled TV screens around the world and on trading floors. Finally someone had been punished for something. A line had been drawn. It was not the rating agencies who declared every CMBS tranche AAA, nor the House Finance Committee Chairman whose oversight over those rating agencies failed to bring any discipline. Still someone was going to prison, and the Dow is up over 20% since then. Additional scrutiny and accountability could further lift the markets just as much as good news over earnings prospects.



In late March 2009 a populist outrage forced the return of contracted bonuses by some AIG managers and employees. In many cases these bonuses were a major portion of the remuneration for highly skilled individuals who had been lured back to help unwind the complex financial instruments that have cost AIG, and now the taxpayers, so many billions. By using a media fanned flame of public rebuke, those who are looking for perpetrators of the recession exacted revenge against those believed responsible. At the same time however, this put into question the standing of contracts. If a contracted bonus payment can be removed by public opinion, what prevents other contracts and their terms from erosion?

*In this environment, everything is negotiable, all the time.*

In the last newsletter it was suggested that job losses would continue on pace through May. That still appears to be the right call. The resulting increase in vacancies for office properties are headed for a national rate of 20% by the end of 2010. In the capital markets, the U.S. Government TALF program hints at components that may revive the CMBS markets. That's the best news of the recovery for Commercial Real Estate (CRE) as outstanding CMBS holdings nearing the end of their term increases dramatically in 2010. A recovery in the debt sector would allow lenders to transfer new loans to balance their holdings as needed. Without a recovery in this key area, it is unlikely that debt would come available in time to prevent a crash in pricing. As spring brings new life to the earth, those who have exhausted their winter reserves, perish. So too in CRE as those who were over leveraged are unable to survive such a long period of frozen markets.



At the peak of the CRE sales bubble, many were heard to complain that deals were being re-traded several times before, during and occasionally even after closing. As the landscape changed, sellers pushed for more and more to maximize their profits on deals that take months to plan and negotiate. Now, those buyers, who were put through the ringer on the way in, are turning to their debt holders and applying the same techniques, threatening to walk away from properties that lenders know they could not sell quickly. Write downs are becoming increasingly common as both sides find ways to survive together. Many owners have dodged or delayed their end by renegotiating existing debt covenants. In these deals, the terms are the important part as the rights of the debt-holders increase, providing them even more opportunity for profits in the longer term. Normalcy will return only when pricing is more stable.

Institutional investors are ruled by their own herd. As professionals holding fiduciary responsibilities, they are punished for straying too far from conventional wisdom. As Geoffrey Dohrmann, President and CEO of Institutional Real Estate, Inc. put it "If they take a chance and win, they get a bonus, if however they fail, they go to prison." In that environment, few would be willing to dramatically reduce pricing on assets now, and sell at 63 cents on the dollar. Instead, they will be forced to ride it all the way down, waiting until the wall of CBMS debt hits in 2010, and sell for much less. But there are always choices. Longer hold periods could prove the right course. As debt markets recover, those able to extend their positions, may find it worthwhile. In addition, derivatives and default swaps, which were just beginning to gain favor in U.S. CRE, may provide the much needed liquidity and flexibility. Still further,

*cash constrained owner/users yield excellent sale lease back opportunities.*

With the dramatic shift in demand and pricing for CRE, the opportunities are greater than they were in the good old days of 2004 through mid 2007. But now, the risks are scrutinized far more closely.



Throughout the economy the mood is shifting. Panic has been replaced by impatience and no small amount of fatigue. Capital is still on the sidelines and lending has not recovered. Yet, there is a growing sense of competition in the air. Conversations are become more focused and pointed. It reminds me of the feeling before the start of a regatta. There are penalties for crossing the line early, so everyone is wary of committing, but they are jockeying for position. The difference between the current situation and a sailboat race is that the actual race will have started long before the news reports it. The predictive indicators are important now to help you with the timing.

Deal flow is still low and pricing is still declining. Will pricing turn as sales volume increases? Or will volume only increase

when pricing falls below a certain level? Clearly there are too many moving parts to say for sure what the precise levels will be for volume or pricing, but there are a few pieces we can state with certainty.

*Transaction volume will increase steadily through the end of 2010.*

With volume as such low levels, this is not a difficult prediction. Further though, volume will increase due to forced sales as delinquencies, which predicate forced sales, have doubled. With CMBS maturities of \$18bn in 2009, more than twice the 2008 volume, and credit markets still stuck in low gear, many owners will face inflexible deadlines. Worse, the numbers nearly double again to \$33bn in 2010, rising steadily through 2012. The peak is in 2017 with \$121bn due. These volumes are 5 and 10 year echoes of the sales volumes of 2002 through 2007. The \$700bn CMBS market is just a fraction of the \$3.5 trillion overall commercial real estate market, but it is more transparent. Clearly pressure is mounting to break the log jam. One way or another, transaction volume will increase.

The last newsletter forecast a 60% decline in pricing by the end of 2011 derived from an increase in cap rates and a decrease in net operating income. Feedback on that piece showed a consensus view of a 35-45% decline though all admit that 60% is also possible. General Growth, the second largest Mall owner in the U.S. filed for bankruptcy on April 16<sup>th</sup> after a long period of successful negotiation with their main debt holders. Finally though, a group of bond holders sued for resolution. This relatively small group's inflexibility forced the end. There are many lessons in this example, especially the need to understand all of the constraints of an organization. Owners holding debt secured by bonds may be unable to negotiate extensions. Lenders able to assist with mezzanine debt, or other small components may be able to do so at very high yields and with greater than normal rights in case of default. In this environment, I expect increasing opportunities requiring the following information different data for different aspects of CRE business. The resources page on <http://www.caswell.org/resources.asp> can help you find these and other sources. I can help you navigate the optimal methods for choosing, contracting and using these sources.

**Key Data and Indicators**

	Point Of View			Leading Sources
	Tenants	Owners	Lenders	
<b>Macro</b>				
Market Overviews	Rents and Vacancies	Cap Rates, Volume, Price/sf	Rents and Vacancies	Brokerage Web Sites, Real Capital Analytics
Leading Indicators	Concessions	10 year T-bill, Confidence	LIBOR, Corporate Bond yields	BEA, BLS, Conference Board
Forecast Scenarios	Absorption	Construction, Absorption	Defaults	PPR, TWR
<b>Micro</b>				
Available Properties	Direct and sub-let space	For Sale	For Sale	LoopNet
Distressed	Likely available for lease soon.	Properties likely amenable to low price offer	Buy existing notes at deep discounts	CoStar, LexisNexis
Manager Details	What is their cash flow compared with yours? Trade initial free rent for longer term?	Look at entire portfolios of each party.	Look at leverage of each party.	LexisNexis, Independent Research

Researching properties, markets and organizations is important in identifying opportunities and developing strategies. Use of services like First American Corelogic, CoStar, LoopNet, RCA and LexisNexis can make the job significantly easier and more effective. Free sites such as Black Book Online can provide access to much of the same information, but will cost you days of searching and will still be incomplete. It is important to stay organized. Every day you need to communicate with your partners, clients, and team. Tools like Leo Software make this easier, even as you must provide more transparency on your activities.

*An efficient decision-making infrastructure supports speed in execution.*

Establish a decision support system and update it monthly, planning ahead for multiple scenarios. When the starting gun sounds, you don't want to be caught trying to figure out the impact of rapid changes on your interests and plans. Use this lull as the ideal time to hone your strategy. What are your requirements and needs? How do they compare to others? What is the relationship you could have with others' who have similar, or opposite needs? For example, if you must maintain a steady positive return in every quarter, how can you partner with others willing to take more variability but are looking for an eventual home run? Identify where you are flexible and where you need assurances. Position these concepts around your existing interests, and then apply them to other situations. You may quickly find situations where a trade produces a mutual benefit. As always, find ways to break yourself from rigid thinking patterns. Humor, role playing, or transposing your situation into sports or entertainment metaphors can help identify creative ideas. Spending a little time exploring the what-if outcomes is useful before applying the inevitable skepticism. Of course, engaging an experienced outside consultant can be very helpful as well. Exposing yourself to questions about your current situation can often help you realize better answers. Thorough research about your competition, individuals, properties, and the markets will help you quantify the values of new ideas. Put it all in a decision system so you can quickly remember the results of each exercise and reevaluate them in the face of updated information. So what are your creative concepts? Please send a note and let me know what you think is interesting to explore.

## **What Really Happened Here?**

This newsletter is more than it appears. It is a mix of the following skills:

**Research** - Writing about Commercial Real Estate in an informative and compelling manner.

**Marketing** – Getting the message in front of the right people – You!

**I.T.** – The distribution email was generated from a program I wrote that embeds unique links into each email while still sending it through Microsoft Outlook so I can find it in my **Sent Items**. The embedded links help me track when you viewed the email. When you continued to the web to view the article, it tracked that too, linking it to the originating email. These databases, programs, emails, and web pages are all integrated around campaigns. I wrote each component using simple tools to avoid constraints of third party tools as well as wasted time dealing with version upgrades.

**Project Management** – Getting it all done in a reasonable amount of time meant making choices around content, quality, timeliness, tool sets, speed, and more. Incorporating the efforts of proofreaders, editors, permissions from sources, and other demands on time requires strong project management experience.

**Strategy** – You are looking at it. I am an experienced professional with experience in multiple disciplines. The best way to explain what I can do is to show you. In searching for work, I apply strategies to networking and self promotion. The point is not the content, but the approach. Wouldn't you want someone who puts this much thought and care into everything they do, working for you?

So how can I help you? I am available to work full time or as a consultant. Let me help you take your business to the next level.

Regards,



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