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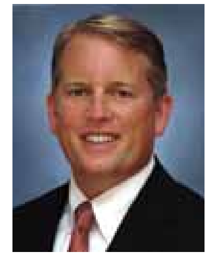

Andrew Morris, SIOR

Panel handicaps market recovery chances

A panel of five veterans of real estate and construction provided industry insights at IBJ's Power Breakfast May 1 at the Westin Indianapolis.

The panelists were:
Mary Beth Kohart, a principal and vice president in the local office of Colliers Turley Martin Tucker;
Danny Marr, a partner and principal broker for Veritas Realty;
Andrew Morris, a principal and industrial team leader for Summit Realty Group;
Ersal Ozdemir, founder and CEO of Keystone Group;
and John Robinson, vice president in the local office of Jones Lang LaSalle.

The conversation was moderated by IBJ real estate reporter Cory Schouten. The following is an edited transcript:

STIMULUS: *In what ways do you expect federal stimulus efforts to bolster the local real estate business?*

KOHART: I have heard a saying that typifies where we are, and the saying goes like this: "The echo remains in the valley a long time after the singer has left the mountaintop." If you think about that, the song has just left the singer's lips. Something that we might consider is Ronald Reagan Parkway. If the stimulus dollars perhaps were used there, that would open a path for development that would connect growing communities right now; and office might be a use because there would be access to higher-end residential. As you know in Indianapolis, office users like to have their offices close for the decision makers.

MORRIS: I think from an industrial standpoint, the fact that we are going to continue to see more money injected into Major Moves and allow for our fantastic infrastructure for warehouse and distribution and logistics to continue to grow and outpace other markets is a real plus. There are several million dollars available for economic environment cleanup projects, in particular within the central business district.

OZDEMIR: From the construction side of it, I think most of the stimulus money is going to help more infrastructure contractors because I think about $270 million will go to the city of Indianapolis. Different states and the state of Indiana asked for the stimulus money and I assume neighborhood stabilization funds will be released later this year. I think it is going to help the area neighborhoods. It might have a direct impact on commercial real estate. It is good to be in infrastructure construction for roads and highways.

MARR: To the degree that the stimulus bill and the other programs help put people back to work, obviously it is going to be a benefit to everybody because those who are jobless will be able to make their mortgage payments and add to the economy by increasing their discretionary spending. Obviously, construction jobs will increase tremendously. Other news by the government as far as the stimulus should help the housing market. Probably one of the biggest changes, for first-home buyers, the $7,500 that was going to be just a loan basically on their tax is now an $8,000 credit, and I think that's going to get a lot of first-home buyers getting out there and buying their first house.

ROBINSON: From my standpoint, it is going to create jobs, which obviously we need right now because the job loss has really been a big factor for the vacancy and the downfall. But, you know, if you are a company that builds roads and bridges, it is a great plan. Other than that, I am not sure it is going to have that big of an impact on many of us.

RETAIL: *We'll start this one with Danny. If new retail development is dead for a decade, as Simon Property Group CEO David Simon suggested in a recent conference call with Wall Street analysts, what are retail developers supposed to do now?*

MARR: Well, play around on the computer a lot. That's a lot of fun. (laughter) You know, you try to take care of your tenants. It is a tough time for retail, as is office, as is industrial. You know, you get a lot of calls from tenants. They struggle and you feel for them; unfortunately, you still have mortgage payments to make. So you do what you can when you can. You analyze each request for a rent reduction or whatever it might be. But sometimes you get some form letters from national tenants and it is kind of obvious they are sending it to every single landlord at every location across the country, looking for rent relief and, you know, in those situations you say, well, send us your financials and we will see how you are doing.

ROBINSON: That's not a lot different from the office developers right now. I lease Keystone at the Crossing, which is 1.2 million square feet. Pretty much every week we get a letter from somebody who moved out in the middle of the night and are gone, or are going to move out (because) they can't pay rent in May. What do you do? You come back and you say, "Were you overpaying me when you were making a lot of money?" They weren't; they were just paying the rent. So they have got a lease. And the tenants seem to talk, too. If you give somebody a discount and then they go back and the next one is going to try to get a discount. It is a real pickle.

MORRIS: I just want to jump in here and just give a little bit of a pitch for Danny's business as well as for all of us. We can do a lot to help each of us if you go out and spend some money. It is all right here in your head just how bad or good things really are. I think a lot of us could pay a little bit less attention to what we see on TV or other things, but it is really not as bad as we all believe it to be and a lot of it is just going to be us getting out there and being bullish about our lives as consumers. And so I will put in the pitch, go out and go shopping this weekend and help all the mall folks and turn this 10-year into a nine year cycle.

OZDEMIR: I think I am coming from a different background. It was amazing to see a lot of money spent for everything construction. Carpenters work and make enough money to have one truck, two trucks, one home and a vacation place, and it is not normal for the rest of the world. So mine will be opposite of Andrew. I think we should save and we should—we need—to scale back. Are we going to be able to have that much of a growth again? Not anytime soon. But if you are focusing on what you have and trying to maximize your cost and when there is opportunity, you will be ready for it.

KOHART: With the office market, the indicators are down but, again, thinking about Indianapolis, it is wonderfully stable and I think stable is sexy now because the coastal cities have such great growth and velocity, and we just haven't seen those ups and downs.

BANKS: The Wall Street Journal recently reported that Boston properties had secured a $230 million construction loan. Apparently some banks are lending, but how tough are the terms?

OZDEMIR: Talking to some of the bankers, the banks do have the money. On the commercial side, banks are lending but it is very tough. I think they are lending to their good customers. If you don't have a banking relationship with them prior, I don't think they lend. There is very limited money out there, and they are going to choose based on clients they want to keep, they trust, and they have a good relationship with. It takes longer. The rates are set by them; there is no negotiating. But I think banks have been working with commercial clients to work out some of the existing real estate deals. In the second and third quarters, we are going to see more banks taking properties back, and then we are going to have to figure out if they need to flush some of these properties.

ROBINSON: If you are going to get money, there will be recourse on it and that's going to keep a lot of people from entering the game. It's a big game changer for most people, whether they are willing to put their personal financial statement up. So most of what's happening right now is, we have got $300 billion in commercial mortgages that are set to mature between now and the end of '12, and it is anticipated that 40 percent of those are going to go back in default. So the banks right now are all preparing to deal with those as opposed to putting more money out into that market. And what is going to happen is, these properties are all going to go back in foreclosure. Banks will have to take them back and deal with property management and deal with trying to dispose of them, and that's when the investment market will start to pick back up. Right now, there are vulture firms that have been formed. They have got cash and are waiting for everyone to start unloading at discount prices.

INVESTORS: *So how do individual investors or individual companies become winners in this whole process?*

ROBINSON: Well, hopefully you started a long time ago thinking about how to become a winner. That would be reserving cash. And for the people that borrowed, the people that have loan values at 90 percent, mortgages coming up in the next couple years, they are going to lose all their equity. It is not a matter of if; it is a matter of when. How do you become a winner? Hopefully, you put money in some of these vulture funds. If you go back to the '90s, I got in business in September of '89. In the '90s, early '90s, almost every building between 86th and 126th Street on Meridian went back in foreclosure, some of them multiple times. How do you become a winner? You start buying these buildings for $20 and $30 a square foot and hold them. That's how you become a winner. Anybody have $50 million? I don't. Ersal does. (laughter)

OZDEMIR: I have it in Turkish liras.

MARR: I have to be careful what I say because my banker is in the audience, but we have certainly seen a big change in the lending environment, really starting with the whole collapse of the mortgage-backed securities market and the conduits getting out of the business. There is a huge place for us to put our firm in. You go from construction loan to bank for a permanent loan, that market has gotten pretty tough. The options are fewer, and when the options get fewer, generally the price goes up on things.

MORRIS: A friend of mine actually focuses his attention on buying notes and non-performing notes, and, as he put it, there is so much to buy out there that he has deal fatigue from just picking through it. I think this is where we all need to be poised as opportunists to realize that there are going to be tremendous opportunities that are coming out in front of us. We still haven't even seen the eye of the storm, from a commercial standpoint. It is accelerated enough that we feel like, OK, it is starting to come our way as properties maybe begin to trade or some notes begin to trade, it will be a little bit of a herd mentality. Position yourself as an opportunist to really be prepared, but stick with the market that you are most comfortable with.

As a follow-up, are there many buyers of actual properties or are most people just looking at the debt?

MORRIS: One of my colleagues here told me the other day that bankers say, well, don't call me up and ask me what properties are problematic; they are overwhelmed with that. You have got to talk to them property-specific. But the only way you can do that is if you really are focused on your market. There is a lot of window shopping going on. You go out to the mall and you will find that the parking lot is full of cars, but how many people are actually walking around with bags hanging over their arm?

ROBINSON: I don't think there are buyers or sellers out there right now. The buyers and sellers are in a standoff. It won't be until the properties work through this distress process and come out and there is something to point to, some floor, some price point where there is not just total chaos in the market, that the standstill will end.

OZDEMIR: Sellers that have actually owned property for a long time, they are used to getting whatever they are getting, and they are not going to get that. And the buyers are in the position they know they can actually get it financed, but they want to wait and see where this is going to go down. So if you are thinking you should pay 20, 30 cents on the dollar to buy a property, the sellers are not going to take that. Times have changed.

KOHART: Some of my colleagues focus specifically on investment and they are quick to say that the sellers have actually been quicker to sell and it is the buyers, because there is this vulture mentality, that's where the shifting probably needs to begin to occur.

ROBINSON: Nobody wants to be first.

AIRPORT: *We are going to pose a question to Andrew. The new airport opened last year so I am curious if you have seen any changes with the distribution market in that area and also whether you have heard about progress on the old terminal.*

MORRIS: Honestly, there are a lot of different ideas kicking around for the old terminal and we could run through all of those right now, but I think it is very, very premature. There has been a lot of change within the airport authority which will pretty much drive that, along with the city. I think the presence or lack of substantial presence of a rail hub or inner modal will affect things more than necessarily the airport. I think what everybody should focus in on, though, is Marion County's new position with a new 10-year tax abatement program in place for the AmeriPlex Park, Global Connect. When things come back and development can finally start again, you have got an opportunity there from a logistics and distribution standpoint.

SPACE: *Are more companies opting to stay in their existing space rather than upgrade to new buildings?*

ROBINSON: I don't think so. This is a time for flexibility and the difference between owning and renting is really flexibility. The leases roll over every five years, you can walk away. On the ownership side, you are subject to market conditions whatever time you want to sell. Most of the tenants are looking for value right now, and value today is different than it was five years ago. Five years ago, value meant a nice environment, amenities that would attract the top talent and retain their employees. That's not so important anymore. Unemployment is at 10 percent, so you can pretty much hire at will. Today, value is cheap rent and flexible lease terms.

CIB: *As we speak, there is still no solution in the Capital Improvement Board's budget deficit. Can you talk about the stakes and also what you think ought to be done?*

OZDEMIR: I live in Carmel; my office is downtown. I see this whole area as a regionalization. When I am out of town, I don't say I live in Carmel, I say I live in Indianapolis. So I think ideally I would like to see that become a state or regional issue. Hopefully, they will have some time to think about it and come up with a plan that makes sense and that everybody can live with.

MARR: I read in the news that if they don't solve it quickly that they may have to start calling some of the events and canceling. That seems to me to be the opposite thing of what you want to do. I think you want to try and figure every way to increase the revenue as opposed to closing the facility. I mean, I'm sure that's being done. But obviously taxes are going to have to be raised. Can we give the $100 million retractable roof back? It is a tough one. I don't think it is time to be pointing fingers. You don't look back, you look forward and go figure out a way to get this thing paid for.

MORRIS: I would like to chime in and ask everybody to get on the phone with your elected officials because, if I understand it, they passed a bill that teen-agers can't use a cell phone [while driving] but we can't come up with a state budget. And so I guess right now this thing is playing out more in the media than it is sitting around a table just hashing where is the pain going to be and getting it over with. I have got people calling me saying, "Hey, I heard the Pacers are moving to Kansas City." That's not good for any of us. And so it would be nice if the people that are really in control come up with a solution and do it quick, decisively, do it behind closed doors like the private sector does.

ROBINSON: It probably shouldn't have been built in the first place. I know it is a big amenity for downtown, but the timing was terrible. And, you know, in a lot of these cases, we build big stadiums and spend all this money and they are really trying to build a city from the top down, and when you look at the IPS school system, it is terrible. We should try building from the bottom up. (applause)

DEVELOPERS: *We have seen home builders close up shop recently. Do you expect to see commercial developers in Indianapolis seek bankruptcy protection?*

ROBINSON: For all intents and purposes, we have got five to 10 major commercial developers that have gone through significant reductions already, and there may be some fallout left. You have very talented people without jobs, and your opportunists are going to start up something. They are more nimble, and they are going to be the ones to start another round of development.

MARR: I assume you are not talking about Simon and Duke, which raised $1 billion each in recent days in the marketplace. But, those developers out on the edge, that are pretty aggressive with new projects in other markets, et cetera, this recession on the commercial real estate side has hit pretty quickly.

ROBINSON: There is a certain development model that won't work anymore. It is like phone booths, pay phone booths. Who is in the business of going out and putting up pay phone booths right now? Nobody. That's gone. Those companies are going to have to go and find something else to do.

MORRIS: There is a real disconnect between the model and what the reality is right now, and in varying degrees. But I think that's the case for all of us whether you are a developer, a contractor, a broker. There will be change, there will be pain with it, but in there lies an opportunity.

BOOM: *What is the best way to position your company to ride out the hard times and be ready for the next boom period. We can start with Mary Beth.*

KOHART: I would just challenge people to say, 'How do you make your real estate work for you?' That sounds very cliché, but really, this is the time when people need to dig down and understand what they are going to be when they come ut of this. And I think a lot of companies are doing that now and I would challenge them to be a little bit more scientific when they figure that out, and they are starting to figure that out, how it translates into their space. Retailers have always been very good about figuring out where their customers are coming from, the demographics. Office really hasn't done that. So figuring out who are your customers, how are your employees connecting with each other, and putting that into their space.

MARR: First of all, it is presumptuous to assume that there is going to be another boom time in the near future. Most reports indicate we can expect slow growth. Once the economy does turn around, it is not projected to return to stabilize in the 5-percent range until some time in 2013. So with that said, the prudent companies are cutting debt and raising capital. That's sort of the bottom line. And some good examples of that are large REITs out there, including a couple here in town. Those companies are looking ahead and saying, "What's going on in the market?" Well, values are dropping, there are going to be opportunities out there.

MORRIS: You know, the greatest hockey player to ever play, Wayne Gretzky, summed it up when asked why he was so successful. It wasn't that he knew where the puck was at that time; he had an innate sense of where the puck was going to be before a play even developed. I really think that's what we all need to look at. There is still a lot more correction that is oing to need to happen. It shocks you, but instead of focusing on the current circumstances, focus on where you think things are going to be next and how you position yourself. I think somebody that demonstrates how to shift themselves is Browning Investments. They were really known for developing the office market for a long, long time, and made a shift and a great play. From a distribution standpoint, there was about 3 million square feet of new development over 15 years and primarily in Plainfield. And lo and behold, they positioned themselves such that when we did 7 million square feet and 5 million square feet in 2006 and 2007, who was doing most of that?

OZDEMIR: I think staying positive helps, but it is also important to be realistic. And we all know a company that did great development and has done well, they had good starts and they had good intentions. I mean we probably got too sophisticated somewhere. There are basic rules that apply and I think the ones that are able to get back to that and stay focused on what they were good at and did well and adjust, cut cost, they will be able to survive. When the market comes back, they will be in a better position. If they don't, they won't be around.

ROBINSON: We are trying not to spend as much money, entertain a little bit less. We are going to cut costs, we are going to really focus on our customer relationships. You can't make as much money on your relationships right now, but you can certainly be in a position to secure those and make sure you are in the right place at the right time. You have got to retain the key talent; we have got a lot of brokers that aren't making as much money. You have got to make sure you retain that key talent because it is very hard to get back when the market turns.

RAIL: *How important is the development of a light rail transportation system in the northeast corridor to commercial development; and, also, would other corridors be better from a development standpoint?*

MORRIS: I think we have been able to get along this long without it; we probably will continue to, but certainly I think we all recognize that the transportation infrastructure in general and our modes of transportation, the way we go about it, is challenged and will continue to be. But the opportunity to develop the northeast corridor certainly will spur a lot of things. If you think about [it], just the median income in Fishers is the same as San Francisco and you can buy a house for half the amount you would if you lived in San Francisco. So there is a tremendous amount of buying power there and it is a great market.

ROBINSON: We are going to have to look at some form of public transportation. We are one of the few cities that it just doesn't exist for all intents and purposes. And the farther we get spread out and the more dense Marion County gets—the congestion is going to become a major issue at some point.

OZDEMIR: I was on a trip last year with the mayor and chamber in Denver to just look at the transit system that I think started 15 years ago; they have 23 miles built. It really takes time. We visited cities that have benefited from the transit-oriented development, train stops. Where there are train stops, people like to live close to that and so there is some development farther out in those areas.

KOHART: I think it is really fundamental infrastructure, that instead of casinos, this is what we should be putting energy and resources toward. It is a very basic component of Denver's landscape; it has allowed a lot of good things to happen. Again, let's focus on greening. Even though it is better than 18 months ago, we are going to start seeing those energy prices going back up, and it is still very fresh in my mind.