

Legal issues 2011:

The challenge of growing business in a down economy

By Dan Rafter, Editor

It's not easy to build business in a down year. Ask any commercial real estate developer or broker in the Midwest. But commercial real estate professionals do have allies in their efforts to nab new business, the commercial real estate attorneys working in cities across the region.

Minnesota Real Estate Journal recently spoke to three of these commercial real estate specialists about the challenges that their real estate clients are facing as 2011 moves into its second half.

Bill Gagliano
Chair of the real estate group at
Ulmer & Berne
Cleveland

The continual challenge of securing financing: The issues seem to be similar to the issues of last year. It's all about the difficulty of growing the business in what is still a down real estate economy. A big part of this challenge is the financing side of things.

The best companies are able to find the financing they need. There are a lot of opportunities out there that people aren't aware of. Essentially, it's about looking hard and finding the means to make a deal.

What it takes to nab those financing dollars: People who are cash strong and have less of a need for financing are

finding it easier to get financing. They are finding a lot of great deals out there.

Signs of life: The growth that we are seeing in some sectors of the commercial real estate business isn't necessarily all across the board. We are experiencing a good market as far as multi-family residential goes. Financing seems to be there for those projects. Multi-family occupancy is up, while vacancies are around 3 percent in the Cleveland market. And so, the multi-family market has been strong.

The fundamentals matter: Those with good projects that pencil out well are finding that getting their loans is not as difficult as it may have been in 2009 and 2010. Financing is still an issue. It's more of a business issue than it is a legal issue. Where it becomes a legal issue is in our attempts to help those clients look at alternative sources for financing, the tax credit area, the energy credits, the historical and low-income tax credits, the new markets tax credits. Those are all areas where there are some opportunities to plug the financing gaps. A real estate attorney can help educate the clients in that area. This year is the same as last year: There is a general sense that we are getting better. But it's still sources



Gagliano



Ranum



Griffith

of capital and sources of financing that are driving everything.

Making a case: If you are talking about the acquisition of an exiting project, you are looking at underwriting standards that are tougher than they may have been in 2005 and 2006 but aren't as bad as they were in 2009 and 2008. Every lender says, and every third-party investor says, that you need to have enough skin in the game. Anybody who is buying or is developing property that they already own better be able to show and demonstrate that they have a substantial enough investment in the property themselves, some equity beyond the traditional 20 percent equity requirements. Everyone wants to know that the individual is taking a risk. Everyone wants to know that the risk isn't falling entirely on third-party investors or lenders. It also helps to have a strong property in a strong market. It helps to have a good market study. Having a good appraisal from a recognized appraisal firm as to what the property

would be worth as developed is also important.

Better times? Everybody says that they are seeing growth in most of the commercial sectors. Leasing seems to be picking up. There are tenants coming back into the market, office tenants, new companies. Everybody is predicting that there will be an improved market for office buildings. There are a lot of things going on in downtown Cleveland, a lot of public/private projects. This is all positive news.

Mary Ranum, chair of the real estate group at Fredrikson & Byron Minneapolis

The downward pull of a weak housing market: Our housing developer clients are dealing with a weak housing market and slow sales in their communities. They are trying to work on continuing to have viable operations when the market is as slow as it is. We are working with them, as we are with many of our clients, to negotiate modifications to agreements with land sellers. We are working with them on negotiating concessions and moratoriums with lenders. The whole housing market is slow. We are dealing with all manner of workouts, amendments and modifications. We have some housing clients we had three or four years ago who are no longer in business. They didn't make it through this most recent downturn.

Hope: With commercial development, there is a little bit of activity. There is a little bit of activity in the medical/office building area, especially, with some build-to-suit projects. There is a little bit of other types of development going on, too. Of course, it's not near the level of activity we saw before the downturn, but there has been a slight increase in activity.

Troubled loans: We continue to do work for lenders who working through

troubled loans. We continue to do a lot of work with foreclosures and workouts. We are starting to see some activity by investors and investment funds looking to purchase distressed assets at a low price. They are trying to make something of those distressed assets. With the low price, they find that they can now get into those assets.

Widespread pain: We do have a wide range of clients. My colleagues and I represent all sectors of the real estate industry. It's a different story for different sectors, but everyone has experienced the slowdown and has made significant adjustments because of it. No matter how they touch the industry, they have suffered from the slowdown.

No housing rescue: I remember when this whole crisis began. There were pundits who were theorizing that three or four years later the housing market would lead us back out. That's certainly not been the case. We haven't worked our way through the foreclosure inventory that is out there. There are so many homes on market, there is little reason for developers to be building new ones. We have some clients who are in the office warehouse, industrial and commercial areas that are doing a little bit of activity. This activity is driven by very strong fundamentals with a committed user. There is very little spec building going on, of course. It is a committed tenant or owner who might need a new facility or new space that might lead a developer to do something new.

The strong survive: There are the few companies that continue to grow. We have a restaurant client that has continued to add new stores throughout the downturn. We have a large retail client that has continued to grow. There are a few companies who continue to add new retail or new locations because they have weathered the downturn very well. We are very happy to have those companies as clients. They have either the right

product mix or the right price point to continue to do well.

Bill Griffith, chair of the real estate and land use practice group at Larkin Hoffman Daly & Lindgren Minneapolis

Public support: I am working with a number of clients on obtaining public support or public subsidies for their projects. In an era of tight lending and tight financing, one of the ways good projects go forward is by securing some sort of public commitment. Sometimes that means public infrastructure like roads or sewers. Sometimes, such as in the new (Radisson Blu) hotel at Mall of America, it means public parking. That hotel will be built over public parking. Other cases involved worker retraining. There are a number of programs that can be accessed at the state and local level. Clients are saying that a project that might have been financeable two years ago no longer is because of tight lending requirements. Sometimes that means public financing is necessary. Is that strictly legal? No, it is a mix of legal and financial. For instance, it took from April 1st of last year when the government signed the jobs bill – there was a provision in there that helped finance the new hotel – until May 1 of this year to close the deal. It took 13 months to put the package together. It was a very complicated deal, but it was a great project and an excellent example of what it takes to get something done in this environment.

Lower volume: Some projects are getting done. Some projects are getting financing. Basically, the good projects are getting done, but it's not at the volume we experienced before the economy slowed down.

What makes a good project: Specialty projects are getting financing. A ballpark, for instance, might get financing. That is a big project. We had two large ballparks – at the University of

Minnesota and for the Minnesota Twins – done recently. We have a third big project in the possible Vikings stadium. More typically, multi-family has been a strong sector. The strength in that sector, and the availability of financing, is driven by low vacancy rates. Senior housing has been a strong sector largely by demographics. Then there are the specialty projects like student housing near the University of Minnesota. Beyond that, there are projects in different corners of the metropolitan area that are being driven by the public sector: the light rail project, the renovation of Union Depot in St. Paul. These are projects that may have been deferred during the eco-

nomie slowdown but are gaining traction today.

New activity: We are seeing a modest increase in activity. That started this spring, not the first of the year, but in the last couple of months. Some of that has been projects that had been put on hold. There is one that I was working on today, a multi-family project that had been on hold for three years and is now going through permitting. The developers are now looking for expedited permitting to meet the multi-family demand that now exists in the market. But we are also seeing projects that weren't permitted or approved and are now ready to go.

We still have the same market demand we had three years ago, but now we have the ability to finance it. There has been a loosening in lending requirements for these types of projects. It's certainly not overwhelming, but there has been a modest improvement in the commercial market.