EAST BAY BUSINESS TIMES

SERVING THE GREATER EAST BAY REGION FRIDAY, MARCH 28, 2008 Volume 10, Number 32 $2

How to pick opportunities in the business cycle

Despite all the talk of economic doom and gloom, there is opportunity today in commercial real estate.

Even as the business cycle turns downward - and the news media is dominated by stories of tightening credit and the subprime mortgage fallout - opportunities exist in commercial real estate depending upon who you are and how well you have prepared.

First, you need to understand the business cycle commercial real estate follows. Second, follow the predictable trend lines of that cycle for guidance, and not the story of the day.

To understand the concept, visualize as a line on a diagram an upwardly trending commercial real estate market slowly hitting the top of its curve and then turning down. As it falls, business people and the market go through different stages: a stage of reassessment, a stage of denial and then a free fall on the way to the bottom.

Today, we are somewhere between denial and free fall on the downward slope.

This isn't a surprise.

Unlike stock market cycles, for example, which are wildly variable, business cycles move more like a supertanker: slow, deliberate and predictable. Understanding the cycle trend lines can put you in a position to take advantage of where the cycle is moving.

Two years ago we thought the data revealed the market at a high point, and so we began advising clients to dispose of assets they might consider selling in the next three or four years. Move to cash and sell before the assets devalue.

John Carpenter
COMMERCIAL REAL ESTATE

So, the subprime mortgage debacle over the past six months didn't cause the commercial slide.

We still think the commercial real estate market's low point will be in 2009 and 2010. The lack of confidence in the financial markets that has followed the mortgage crisis obviously trickles down to the commercial real estate markets, and that will be something to watch.

So where are we at, and where are the opportunities?

The selling opportunity has passed. We are now entering an acquisition and repositioning cycle.

Well-capitalized entities have been sitting on the sidelines and may continue to do so for several months. The smart investors are sorting and studying: Which owners are not well situated? Who has suffered unanticipated tenant losses? Who has been most impacted by the mortgage crisis? Like predators following prey, they are watching, studying and positioning to be at the right place when the time is right.

Gaze across the landscape and it's clear that the number of prey is growing. Retail closures are increasing, as are office vacancy and subleasing. Commercial owners are offering more incentives to attract tenants: gimmicks such as free cars or an exotic trip.

Companies across the country will use this phase of the cycle to restructure their corporate living and financial environment.

And there's the opportunity.

Landlords can't risk losing tenants, and that means some lessees can renegotiate to lower lease rates or can gain in-place concessions. Others will press building owners not only to reduce rates, but to lock in long-term leases with fixed increases.

For the last two years, we've been telling clients to write short-term leases because the economic situation is going to weaken, and if a client can renegotiate a lease at the bottom of a cycle in the next two years, he can save millions of dollars over the next typical five- to 10-year leasing cycle.

Understanding business cycles and how they impact your business, whether you are running a New York Stock Exchange company or a local insurance firm, can help you prepare and avoid surprises.

Examine the cycles and think ahead. Then steer your company to the calmer water that will allow you to take advantage of change.

John Carpenter is a principal of Carpenter/Robbins Commercial Real Estate Inc. in San Ramon. Contact him at jc@crcre.com or 925-866-1300.