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A Few Lessons from Commercial Real Estate Bust

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This is interesting to know commercial real estate is not all in turmoil. Indeed, commercial real estate investors who followed very simple rules and did not aspire to become affluent over night are weathering the storm much more comfortably. Let us review some of the lessons learned.

SOME BACKGROUND

Traditional lenders for commercial real estate have generally been willing to loan up to 65% of the value of the property. That means if you purchase a commercial property for $100 million, the traditional lender would give you up to $65 million and you have to come up with the rest. However, hedge funds and private equity funds who smelled an opportunity to reap profits jumped on the bandwagon offering up to 80% of the property's value. This meant that commercial investors suddenly could pocket the 15% difference and invest it somewhere else. Nonetheless, there was a catch. Such jumbo loans, generally, had to be refinanced within 5 years or so.

As the financial calamity descended, only traditional lenders remained while property values declined and the time for refinancing loomed large. Thus, such commercial property investors were facing the following dreaded reality:

- **Adjusted Value of Property (Roughly):** $80 million
- **Loan Due for Refinancing to Avoid Payment of Relatively Higher Interest Rates:** $80 million
- **Maximum Loan to Value Ratio by Traditional Lenders (No Hedge Funds or Private Equity Available):** 65%.
- **Maximum Loan Amount From Traditional Lenders (If still Possible to Secure):** $52 million (65% of $80 million). However, this amount is not all certain. It could very well be, if any, less than the maximum $52 million.
- **Deficiency*:*** At least $28 million ($80million-$52million=$28million) shortfall.

Note, this scenario assumes that the commercial property investors were having positive cash flow with tenants who understand the situation and are willing to stay for less rent.

SOME LESSONS LEARNED

- **Plan On Purchasing Properties You Can Afford:** This is very important to purchase a property you can afford to pay off over several years.
- **Plan On Building Your Real Estate Investment Like Your Retirement:** Think of your real estate investment as your retirement. You cannot tap into your 401K whenever you

desire because at the end you will end up having little at the time of your need. By the same token, do not treat real estate investment as a short-term plan.

- **Plan On Building Your Investment Portfolio Over Time:** Purchase one building at a time. Make an informed decision. Know what you are getting into. Know how much you need to pay if some tenants leave. Know there are costs involved. Know if you made the right decision, in a few years you will buy another property.
- **Plan On Building Long-Term Relationships with Trusted Lenders:** Secure loans from lenders whom you know for the fact have been in business for a long time. Stay away from exotic and untested means of raising funds.

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