
KÖNIG PYNE & CIE. LP

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Experience

Recently the New York Times ran a feature article on what most industry experts now recognize as the growing debt maturity problem in US Commercial Real Estate (“CRE”). The paper cited an “expert” with twelve years of experience. While a decade plus encompasses at least one full investment cycle, I would submit that after three and one half decades in the business encompassing many cycles, that we have to go back to the late 70’s and early 80’s to find a similar framework to understand and then work through what will soon unfold.

Today’s looming US CRE issues include: rising cap rates resulting in declining values, growing direct and indirect vacancies, increasing interest rates, municipalities under growing financial pressure, inflation concerns, little or no transactions and turmoil in our financial markets. The list goes on. Dissimilarities to past cycles include: converging mountains of debt and lease maturities, no overwhelming supply of new inventory being delivered to the market, increasingly complicated forms of financial structures, and today’s seeming lack of seasoned personnel in both the lending and stewardship of properties who know what to do in periods of stress and how to accomplish the task of restoring property value.

As we have not seen what I believe is unfolding before us in more than 25 years, managers with practical experience who have weathered this storm before are in short supply. No disrespect to my juniors, but the only advantage I can see to being older is that I have lived through these events before and can say with confidence that little is new and different this time.

What does experience bring to the table? The answer is patience and the “perspective of time.”

Below are a few of my practical thoughts on how to deal with the growing problems in US CRE.

1. Assemble an experienced team.
2. One of the hardest speeches to make, whether you are a borrower or lender, is to deliver bad news. If you have never done this before, practice in front of the mirror, make sure you have a script and follow it. Under no circumstances ever let a representative deliver this message for you. This is your responsibility.

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3. If you have not lived through a restructure, foreclosures, or bankruptcy proceedings before, learn from someone who has. The first question you should ask is, “have you done this before?” The answer will more than likely preclude more than 95% of the advisors who are now offering their services and expertise.
4. Have a comprehensive plan for the future and do not shy away from making a clear statement of what went wrong (everyone makes mistakes) and why your plan for the future is the best for all involved.
5. Make your plan simple, clear, and flexible.
6. Find out the other sides’ problems and issues.
7. Do not make legal threats as such an approach only exposes the weakness in your position and plan.

From what I have seen at many restructurings, foreclosures and bankruptcy discussions are endless posturing before anyone gets down to the real problem which usually is that the borrower is unable to pay all its obligations. Everyone at the table has an advisor and most probably a lawyer. So everyone is represented except the “property.” In the first round, the advisors all state frankly obvious positions for the record and by the end of the first round everyone is sufficiently aggravated so it is difficult to have a constructive dialogue. So the property suffers.

Focus on the property. Fix the problem not “the symptoms.” Find solutions, not confrontations.

What skill-sets do I think you need on a ‘distress’ team?

1. Management or ownership with demonstrated experience in preserving, restoring and creating value.
2. Management or ownership that has been through bankruptcy, re-structuring and or foreclosures before.
3. Management or ownership that has run an effective re-positioning, renovation and who has run a successful re-tenanting of a property or portfolio of properties under discussion.
4. Management or ownership who is familiar operating a property.
5. Project managers who have been through a programmed capital rehabilitation and re-tenanting of a property.

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6. Experienced architects and engineers who are familiar with the type of property under discussion.
7. A team of lawyers who has completed at least two re-structuring, one bankruptcy, and one foreclosure. There is no substitute for experience.

What is coming is not a “game” for professionals without first hand experience in the process. Debtors and creditors who are not well versed in the process will unnecessarily destroy a great deal of value for no apparent reason.

Property is not an easy asset to manage nor are property problems quickly solved. There are no short term easy fixes in our business and therefore solutions will take time to unfold and bear fruit. So my closing thought is to think thoroughly and take a “patience pill.” I believe those who do, will be rewarded with extraordinary returns.

Sincerely,
Percy R. Pyne IV
Chairman & CEO

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