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## LIQUIDITY VS. FRIGIDITY

**Cash opens doors when credit is locked up.**

Steve Jaffe and Steve Gozini

Here's a test: What's unusual about the following deal? A California investor recently bought an underperforming office building in Virginia for a price well below replacement cost. At the time of sale, the building was 50 percent leased. The investor, a value-added specialist with some tolerance for risk, planned to boost the building's occupancy to 90 percent within 2 years.

So far, nothing is unusual, except this: The buyer paid all cash, and the deal was finished within the past year when the credit crunch was already well underway.

Cash is always welcome in real estate and never more so when credit is tight and banks are jittery about lending. Owners, who must sell, such as those facing balloon payments on their mortgages, are looking almost desperately to be taken out of their debt. Refinancing is often not an option, because the market value of the building has fallen below that of the mortgage and the lending market has all but dried up. In all, this scenario looks very favorable for a buyer who is willing to step up.

Buyers willing to make deals in this environment, however, are as scarce as people looking for ice cream in a Minnesota blizzard. Even more scarce are investors who offer cash for those deals. Scarcity can be a good thing, unless you are on the supply end of the equation. Buyers with cash are likely to get their telephone calls returned and, very often, their offers accepted.

Cash has obvious advantages in a credit-constrained market. Few people have cash at the moment, and those who do are nervous about parting with it. High net-worth investors, who just a few months ago were shopping for the highest yields in the hedge-fund market, now find themselves running to safe havens like treasury bonds, even in cases in which those bonds pay little or no interest. Other investors, meanwhile, plan to wait until the market bottoms out before they go trawling for bargains. In short, the cash buyer who is willing to deal has a lot of potential choices when other buyers are thin on the ground.

Of course, sellers do not need to be distressed to be cheered by the sight of an all-cash buyer. Corporate real estate managers show little aversion to hard money. Take for instance the opportunity of buying vacant stores from Wal-Mart in markets where the Bentonville, Arkansas-based retailer has decided to upgrade from a conventional 100,000-square-foot store (or smaller) to a 200,000-square-foot superstore. The knowledge that a cash buyer is standing by creates a comfort level for corporate real estate managers, who know that they do not need to wait through weeks of uncertainty for a lender to approve the terms. In those circumstances, corporations can become repeat customers for a cash buyer. One Los Angeles-based investment firm has purchased 15 former Wal-Mart stores, most of them empty and some with deferred maintenance, in all-cash deals. The company has successfully re-tenanted the properties to the benefit of Wal-Mart, the new retailers and the communities.

To succeed in this type of investment, especially during economic uncertainty, requires more than cash, however. Investors need to have enough staying power, patience and sheer nerve to find the right tenants for these buildings. Take the case of a 100,000-square-foot facility in Kennewick, a small city near Walla Walla in southeastern Washington. When the world's largest retailer decided to relocate to a larger Supercenter in 2004, the notion of an empty Wal-Mart created concern for both the retailer and this community of 62,300 people. Kennewick city officials feared the impact of a large, conspicuously vacant building on local real estate. Wal-Mart, with an eye to community relations, wanted to minimize any ill effects on Kennewick.

As luck would have it, the K-Mart building next door also put up a for-rent sign. After buying the Wal-Mart, the new property owner had the unenviable task of competing in a small market for big box retailers with a building of equal size a stone's throw away. In the end, the firm swallowed hard and decided to wait for just the right tenant mix to maximize value. It took 3 years and plenty of creativity to refill the empty retail box. The front half of the store is currently occupied by GI Joe's, a retailer of indoor/outdoor equipment, and three smaller tenants, while the rear is a call center for Amazon.com.

Real estate, by definition, is a high-risk, high-reward type of business. Investors who can tolerate market cycles, long lease-up periods and the need for local problem solving will find opportunities in this winter of recession. Rewards do exist for the well-calculated risk. When buying real estate with cash at a time when money is tight, investors may find that prices are more negotiable and more elastic than in good times.

As they say, "When you buy ice cream in a blizzard, you can get any flavor you want."

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