



ALEC J. PACELLA

Bumping Along the Bottom

As I walked along the beach on a recent vacation to the Gulf Coast, I came across several guys surfcasting. For those unfamiliar with this type of fishing, the idea is to stand on the beach and cast over the breaking point of the waves. This allows the bait to flow with the underlying current, all in hopes of landing the “big one.” And as I watched these anglers work their craft, it occurred to me that the current conditions in the real estate market mirrored surfcasting in several ways.

This month, we take a look at where things stand at the halfway point of 2010, answering questions such as what’s biting, what’s not and, most importantly, how is the fishing.

Lots of nibbles but no big strikes

The first half of 2010 has clearly been busier as compared to a year earlier. On the investment side, more properties are on the market for sale and more buyers are looking to buy. On the user side, tenants are out in the market in greater numbers, landlords are actively responding to these tenant inquiries and the appetite for owner/users looking to buy properties has grown. On the lending

side, the overall requirements seem to be loosening, with more banks underwriting real estate deals. Everything sounds good until you look at the bottom line. On the investment side, the closed deals are still painfully thin, with an aggregate sales volume of just \$46 million for the first six months of 2010 (back in the heydays, a \$46 million month would be considered soft). And while things are a little brighter on the user side, the majority of leasing activity involve at least one of these three concepts – shorter lease term, less square footage and less rent. It’s not that there aren’t some big fish out looking but very few are actually committing. As a result, net absorption continues to be very low (if not nega-

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tive), vacancy continues to be static (if not mildly increasing) and rents continue to be flat (if not softening).

Stormy surf still causing turbulence

One of the primary reasons that everyone seems afraid to commit is the continued feeling of economic uncertainty. A good report on GDP growth one day is countered with a bad report on unemployment claims the next day. Ford reports solid profits then Toyota hits the skids. And don't even get me started on the stock market. No one seems to be able to get a real handle on how the infamous "things" are going. So it's no surprise that all of this uncertainty continues to breed conservatism, with neither side willing to concede in an effort to shrink the gap that existing between bid prices and taking prices.

Bottom fishing is popular but what's being caught?

We have all seen the headlines touting the impending implosion in the commercial real estate market. The only people looking for that shoe to fall more than the media are the investors. They have been patiently sitting on the sidelines, cash in hand, waiting for the blue light to start flashing. But a funny thing has happened. Nothing. Sure, there has been a slowly growing string of properties that have slipped into foreclose/receivership, including some landmark buildings such as 800 Superior (KeyBank Investment Center), Commerce Park I, II & III, the Summit Office complex on Rockside Road and the Euclid Arcade, among others. But so far, there has not been the massive wave of foreclosures akin to what occurred in the residential market in 2007 and 2008. And there certainly have not been any clear "bargain bonanza" opportunities for buyers.

A strong line is a must (and a big tackle box will help)

One of the most common complaints that I have heard over the last six months is how difficult it has become to get deals done. A real estate transaction is never easy. Even in good times, it's sometimes a wonder how anything gets done, consider-

Daus, You Know?

THE FALLING FLOOR Two years ago, a large industrial building was sold in the southeast market. The construction quality was very high, as the building was originally built and owned by its occupant. The company was moving, making the building surplus real estate. An investor stepped up and purchased the building for \$36 psf, well below replacement cost. Fast forward to today, where a large industrial building was recently sold in the southeast market, with an eerily similar story - high quality facility built, owned and now being sold by its occupant as surplus real estate. But the price was \$26 psf, a whopping 36% decrease.—AP

ing all of the pitfalls that can occur during the course of a transaction. But, despite the depth and breadth of challenges the past couple years have brought, there are some transactions getting done. And I've noticed a few key characteristics among those that have been successful. By far, the most important is a strong commitment to stick with the transaction to the end, with neither party becoming distracted by the seemingly endless stream of, well, distractions. Also important has been the ability

and willingness to consider solutions outside of what is typically normal. These include concepts such as seller financing, delayed closings, master leases, bridge loans and equity partnerships. Finally, the parties have been willing to adjust their expectations and compromise, realizing that they may not be able to achieve everything they initially had wanted.

Best advice: keep casting

As I passed the surfcasting fishermen, I noticed that none of them had any fish on their stringers. So I stopped and asked how long they had been at it. They said since around 8 a.m. I looked at my watch and it was just before noon. Not exactly how I'd chose to spend four hours of my time but these guys had a passion — they wanted to catch fish. And, despite a hot sun, a rough surf and a lot of nibbles but no big strikes, they continued to cast their lines. Somewhere in there is a lesson for all of us. **P**

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