

COUNSELING THE INSTITUTIONAL CLIENT

by Gary K. DeClark, CRE

Real estate counseling can take many forms. According to official CRE definitions, a real estate counselor is a real estate practitioner whose primary business is providing expert, experienced advisory services to clients for agreed upon fees. The client relies upon the Counselor for skilled and objective aid in the client's real estate needs, implying both trust on the part of the client and trustworthiness on the part of the Counselor. While being objective in the analysis, the Counselor maintains the client's best interest by considering and/or executing various strategies, developing available options and advocating the best position.

Among the various clients who require counseling services, this article focuses on the institutional user. Institutional clients are generally considered high-profile clients who deal with properties which are either larger in scale, larger in value, larger in size or typically part of a larger scale portfolio. These clients will oftentimes acquire, manage, renovate, rehabilitate and/or dispose of investment-grade properties for their domestic or international owners. Many institutional clients require sophisticated, computer-based analyses of the multiple-tenant cash flow oriented parcels of real estate. Institutional clients typically will require a high level of expertise from the Counselor due not only to the high grade investment nature of the property, but also because of the large amount of money involved. Given the basis of institutional practice, how does the Counselor provide service?

Appraisal Possibilities

Those Counselors who also are appraisers may find ample work opportunities with institutional clients. Most pension fund managers, life insurance companies or REITs require annual portfolio appraisals either as a requirement of law or as corporate policy. Many also require appraisals upon property acquisition or disposition. Those clients subscribing to banking law dictum will require a full self-contained narrative-styled report on each property. Others may need something less substantive—a summary report where only a limited appraisal is performed. In the latter instances, typical assignments suggest some sort of a restricted report or limited format. They might include a brief property and area description but would additionally include a detailed income analysis (usually a discounted cash flow on Pro-Ject™, Argus™, Dynalease™, 0/2™ or some other commercially available software), a

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thorough rental study, a complete market analysis or overview and a strong supporting analysis on improved property sales. Sometimes a cost approach is excluded in a traditional sense, but usually a land value analysis is included. Property inspections are sometimes substituted for desktop analyses. Other times only a sampling of the properties are inspected.

Depending on the requirements, an alternative portfolio review could be engaged where previously prepared discounted cash flow analyses are reconsidered and updated; any supplemental corroborating market data could be obtained by telephone research. This latter service provides a second look at properties already under scrutiny by asset or property managers.

With the advent of the technological revolution, clients will be more cognizant of speed and accuracy in their requests for services. Electronic data transfer of information on a matter-of-fact basis is just around the corner. Professionals who have data will be in enviable business positions. Computer analysis, now commonplace in the industry, will continue to be vitally important in real estate analysis. A word of caution suggests, however, that with such electronic information availability, more emphasis will be placed upon proper data input and more so upon proper data analysis undertaken by seasoned and experienced professionals. Clients who traditionally have relied upon larger, national appraisal firms are beginning to re-examine their policies in favor of contracts with smaller boutique-styled firms where seasoned, experienced professionals have greater input into the assignment. Electronic data analysis, speed and computerization cannot take the place of experience and judgment.

Management Opportunities

Opportunities abound for Counselors in management areas, as well. Property and asset management services can be offered regularly to institutional users. Property managers maintain the day-to-day operations of properties either directly or indirectly. By knowing building operations, profitability can be heightened by a knowledgeable Counselor. Keeping operating costs in check and making a contribution to the leasing efforts could translate to increased returns, so vital in today's ultra competitive market.

Asset management, as distinguished from property management, is more concerned with global performance of the portfolio. Asset managers consider all the portfolio's components and attempt to maximize returns. Counselors may lend expertise to the asset manager's decision making regarding how best to maintain the portfolio.

Troubleshooting

Assume a pension fund manager is managing a portfolio of retail properties for a client. Included in this portfolio are several types of shopping centers with various levels of performance. If one of the poorer performing centers is singled out as an asset requiring analysis, the Counselor could offer his professional services including:

- a. analyzing the center's tenant mix;
- b. suggesting ways to reconfigure the tenants' locations;
- c. suggesting possible lease buyouts for non-performing tenants who may be experiencing sales difficulty;
- d. analyzing the various gross sales volumes relative to contract rental payments to determine whether rental payments are too large for sales generated; and
- e. providing ways to restructure any leases (e.g., Is rent too large a percentage of sales volume suggesting a struggling tenant who may not be economically viable?).

The Counselor would also examine any deferred maintenance on the property and consider the ultimate impact on a center's investment return. If the property is sub-standard relative to physical attributes, he could analyze what impact renovation dollars would have on a retented or revitalized shopping center.

- Will the expected higher lease payments from new tenants more than justify the renovation expense?
- Will the new tenancing require substantial tenant improvement expenditures in order to attract a new class of tenancy?
- Will there be a higher shopping center value and/or return to ownership realized by bringing in more creditworthy tenants than those currently in occupancy?

Theoretically, more creditworthy tenants would have a positive impact on expected cash flow and, hence, suggest a reduced risk of investment which in turn augments value.

Ultimately, the Counselor could maintain involvement in the portfolio project analysis from beginning to end by identifying problem properties. Pointing out income and/or expense problems within each property and aiding in retentencing the center may ultimately provide opportunities to dispose of the revitalized property, if such a maneuver is an appropriate exit strategy. Alternatively, would ownership be better served by effectuating a refinancing of the property (if it is currently encumbered by debt) in order to extract cash from the property while still continuing to manage and own it? This is one of many questions a Counselor would need to address.

Build-To-Suit Options

Another scenario for Counselors in the institutional arena is to develop a property under a build-to-suit scenario whereby the counselor/developer constructs a building for a specific user who in turn leases the property on a long term basis from a third party owner. Once the building is built and occupied by the tenant, the Counselor could assist in selling the leased property to an institution which, in turn, maintains ownership and enjoys the cash flow. Obviously, the Counselor can propose a price for the property in part predicated upon the occupying client's creditworthiness and length of leasehold. Comparisons to bond yields or other real estate investment options are sometimes made to properly reflect the risk associated with the build-to-suit rental payment schedule.

Trade Offs

Because institutions typically have large blocks of cash available for a series of investment types, real estate investments must compete on returns with stocks, bonds and other investment modes for investment dollars. Typically only a portion of the entire portfolio can be devoted to real estate ventures either on the side of equity or in the form of debt. The Counselor can aid in the decision as to how much of each form, debt or equity, is optimum. Should comparatively low risk

equity dollars for a long term credit deal be chosen over an alternate deal with possibly higher returns and greater risk? In other words, how will a property net leased for 20 years to a strong manufacturer be compared to a similarly sized industrial redevelopment project? Contributions to such problem solving by the Counselor could be invaluable to the client.

Of primary importance in understanding the institutional client's needs is the fact that this type of client is sophisticated and will likely become even more so. The Counselor must be at least as sophisticated as the client in order to adequately assist the problem-solving process. Thus, the Counselor is a perpetual student of real estate. He must be abreast of current market dynamics, changing legal issues and investment criteria, and he must have knowledge of the market and be a participating member of the market in order to know where to locate information if it is not already available.

Conclusion

It is no surprise that a world of opportunity exists for Counselors in the institutional area. Institutional owners, just like other real estate professionals, are confronted daily with problems which require the high level of integrity, experience and judgment of a skilled, competent real estate counselor. These qualities can only prove invaluable to the institutional client.

W i s d o m

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