International Council of Shopping Centers

UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON
OVERSIGHT AND INVESTIGATIONS

COMMERCIAL REAL ESTATE: A CHICAGO PERSPECTIVE ON THE PROBLEMS AND SOLUTIONS

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STATEMENT OF PETER BORZAK
PINE TREE COMMERCIAL REALTY
ON BEHALF OF
THE INTERNATIONAL COUNCIL OF SHOPPING CENTERS

Thank you for conducting today's hearing on commercial real estate (CRE). This is an important issue to every community across the country, but nowhere more than Chicago.

My name is Peter Borzak and I am the Principal for Pine Tree Commercial Realty. Founded in 1995, Pine Tree is located in Northbrook, Illinois and is a recognized leader in the development, acquisition, leasing and management of retail properties throughout the United States.

I am appearing today on behalf of the ICSC. Founded in 1957, ICSC is the premier global retail real estate trade association for the shopping center industry. Its more than 55,000 members in over 92 countries include shopping center owners, developers, managers, marketing specialists, investors, retailers and brokers, as well as academics and public officials. In 2009, shopping center related employment account for more than 500,000 jobs in the state of Illinois.

Thirty years ago real estate capital largely came from local private investors and bank relationships. Since then, the CRE industry has become more institutionalized. In the years leading up to the credit crisis, the supply of capital exceeded the supply of property and a relative valuation bubble was created. As the securitization market became heated, rating agencies neglected their responsibilities. The Commercial Mortgage Backed Securities model and the efficient delivery of credit is an important catalyst for economic recovery, but the problems with mislabeling risk need to be addressed.

Today, the CRE market is trying to find market stability and establish new valuations, but the lack of credit presents a significant obstacle. Assets need to be deleveraged and capital investment to attract new tenants needs to be obtained, but there is very little bank lending and only a glimmer of hope that CMBS lending will appreciably return soon.

For CRE, the credit crisis continues. The majority of ICSC's owner / developer members are private businessmen like me, many of whom are experiencing a difficult time trying to find credit while facing maturing loans and the potential of foreclosure. According to various sources, $1.4 trillion in commercial real estate loans will require refinancing from 2010 through 2014 and nearly half of these loans are "underwater", meaning the property is worth less than the existing loan amount. The amount of bank-held CRE debt coming due will peak in 2012, with large amounts of Commercial Mortgage Backed Securities coming due in 2015-2017.

Like many CRE owners, we have been faced with the dilemma of working out several maturing loans with very few if any viable credit options. During 2009, we were able to find resolutions to many of our bank loans, but in most cases, those resolutions included the investment of additional equity dollars to reduce the leverage level, or required us to finance the retirement of the loan entirely with equity funding. As an example, we had an asset facing a maturity default that was 85% leased and 100% of the fully leased loan-to-value ratio. The bank required $500,000 of additional equity and tenant improvements to increase the lease level to 95%. For this additional investment we were granted a 3 year extension with annual hurdles.

We were fortunate to be able to access the equity funding to facilitate this loan resolution. Many others in our industry have not been able to access those equity funds, and many have lost the equity that was held in their real estate portfolios because of the decrease in asset values and increase in vacancy that resulted from the recession.

In addition to our bank workouts, we are currently trying to work with special servicers regarding two maturing CMBS loans. In one case it looks as if we will not be able to reach a reasonable resolution and will have look elsewhere for a new loan, potentially with a mortgage fund. CMBS special servicers are much harder to access than a bank and have less flexibility in a work-out.

Over the last year and a half ICSC has been working to get to the root of the credit problems facing the retail real estate industry and has created a proposal to give the commercial real estate market tools to recover from the economic downturn. At this time, ICSC believes that the largest obstacle facing the restart of the CRE market is the equity gap between existing loan amounts and current values, as I described above.

Unlike residential real estate, CRE borrowers will put additional equity into their assets, if they can access the capital and it makes economic sense. In order to address this problem, ICSC is pushing forward with a temporary and targeted enhanced depreciation proposal that will provide 50% bonus depreciation for new investment in existing distressed commercial real estate. The new capital will be tied to paying down the debt on the asset, with a portion allowed for job creation and capital improvements in the property. The proposal enjoys the support of the Independent Community Bankers Association and the National Association of Realtors.

ICSC believes that deleveraging CRE debt, largely held by regional and community banks, with fresh capital and new underwriting standards will help local economies recover faster and keep hometown banks in our communities. In addition to helping the credit needs of our owner/developers, we are also hearing from our tenants that small business loans are hard to access. Community banks are the main source of small business lending to many mom-and-pop retailers, and this proposal will help community banks that are trying to unwind commercial real estate debt from their balance sheet and increase small business lending capabilities.

Access to capital and credit are truly the biggest problems facing our industry and while ICSC is putting forth this thoughtful proposal, the industry is also fighting against two major efforts to undercut capital creation in real estate; Increasing the tax on carried interest and one-size-fits-all risk retention standards for Commercial Mortgage Backed Securities.

Simply stated, I believe if a carried interest tax increase is enacted, it will severely inhibit local developers and operators and lead to job loss through less development and consolidation of local development by major national institutions. In addition, it will inhibit local developers and operators from making investments, as the current structure encourages them to align their interest with their investing partners and the success of the project rather than simply creating a structure that pays short term fees at the beginning of the project.

Furthermore, this tax will make investment in underserved markets far less feasible to developers because of the increased risk. The net result will be to cause harm to those communities that need development and revitalization the most. A lack of retail options leads to higher prices for basic commodities like milk and bread for those people who can least afford to pay.

Community leaders where we do business fully understand and appreciate the benefits our development brings to their citizens - - more consumer choices at lower cost; more job opportunities, both at the construction phase and thereafter; an increased tax base and an improved quality of life. In fact, the U.S. Conference of Mayors and the National Association of Counties have both passed resolutions in opposition to this tax increase on CRE.

As for risk retention standards for asset-backed securities, ICSC believes that “skin-in-the-game” is an important market protection to bring more safety and soundness to the market, leading to increased investor confidence. However, ICSC supports the Senate passed amendment and similar language passed in the House to allow regulators flexibility in determining the most appropriate form of risk retention for commercial real estate finance instead of a fixed 5% risk retention level, which will likely lead to reduced credit availability when paired with recent FASB accounting requirements.

At the end of the day, the issues discussed today are not about Wall Street but about Main Street. The CRE issue is a major systemic economic issue threatening job creation, economic development, and revitalization of communities across the country.

Thank you for holding today's hearing and for giving me the opportunity to testify. I look forward to working with you as you continue to examine this important area. I welcome any questions.