TABLE of EXPERTS

COMMERCIAL REAL ESTATE

Trying to measure economic growth? One vital indicator is the health of the commercial real estate market. The *Albany Business Review* hosted a conversation with three people involved in the industry on how the financing of deals has changed, why a talent shortage is impacting operations and whether the region has too many apartments in the pipeline.

When you're considering financing for a commercial real estate asset, what are some of the factors that should be considered?

Charles Cronin Jr.: You have to think about a lot of factors when you're financing a piece of real estate. You can do long-term fixed rate financing, but there are things that you have to build into a financing, like the assumability of a financing, so somebody else can step in. How much leverage is on a piece of property? As time goes on, does the value of the property go up, and as a result, do you then have to add additional leverage if you want to sell it? Because who's going to buy something for 30 percent of the value and pay cash for 70?

Do you find that most people don't have that long-range view of all of it?

Cronin: Unfortunately, a lot of times, they don't. And interest rate sensitivity has a tendency to drive many of the decisions on a day-to-day basis, and people sometimes jump into situations not fully thinking through some of the various aspects of financing and what it means in the long term.

John Allen: Prepayment penalty is a big issue. A borrower can get a rate whether he or she is refinancing an existing property or buying a property. And it looks like an attractive rate, but none of us have crystal balls to go 10 years down the road. And clients can find themselves in a situation, particularly if their prepayment is a yield maintenance, or rates go down so it's a good time to refinance, but the prepayment penalty negates your ability to do it.

It's a little bit amazing to me that the lenders are making it so difficult. I would think that they would want to make it easier.

Cronin: I don't think they want to make it difficult. I think what we have today is unprecedented. In the '50s, 5 1/2 percent was a very reasonable level of interest rate. When you look at prepayment penalties, put yourself in the position of an institution. If you went to Capital Bank and said I want a CD for 5 1/2 percent in 1950 for 55 years, you'd be upset if they came back and said, "Well, I'm sorry. Interest rates have changed. I'm not going to pay you your 5 1/2 percent." That's the same thing that lenders do, whether it be Capital Bank or insurance companies, et cetera. What's happened is that the interest rates scenario has changed so dramatically, so quickly as a result of the 2008 crash. And so previously, 5 1/2 percent was a very good interest rate. But when the 10-year treasury is sitting at 1.65, there's a big delta.

Allen: I think certainly, if a borrower has a relationship with a lender – and I think it's easier with the local banks that you do business with – if you have a prepayment schedule that may go 5, 4, 3, 2, 1, or 5, 5, 4, 4, 3, 3 if it's a longer term, you know what it is. If you have a yield maintenance, you really don't know what it is. And one is a little easier to plan for.

As far as the capital sources that are available to finance the projects, what kind of options do people have?

Cronin: I think there's a multitude of options. I'll categorize them. Four general areas – two general areas: The institutional and then the banks. You have banks; you have insurance companies; you have pension funds and non-traditional sources such as private equity firms; and then you have securitization, which is Wall Street securitization where they take bunches of loans and put them into a pool. Each one of those in my opinion has different advantages. But I think if you look at the products that those institutions have, you can pretty much figure out where to best put things.

Allen: If the borrower wants to sell down the road, you probably don't want to get into a securitized financing because it's very, very difficult to get it out. I had one situation once where there was a property in part of a large securitized financing where the borrower had actually bargained to get a certain number of properties out. They were a trust. They had real estate across the country. They were willing to sell a particular property that the client wanted to buy, but they had removed from the financing everything they could remove. So there was some public interest in this particular property in seeing something happen with it. So we were able to work with the municipality that was involved, and actually, they went through the beginning of the condemnation, the eminent domain process to acquire the property for what was considered a public use, and that enabled the borrower to go to the lender and be able to get it released. That's a pretty extreme situation. That's something – you can't pull the condemnation card out of your back pocket.

I'm interested in everybody's take on the ability to recreate traditional downtown areas with all of the positive trends that are happening. And then, what is the up-and-coming area that you see where we might see that happening first? We know the general things that are happening in the area. Can we recreate that downtown?

Daniel Fariello: It becomes a chicken or the egg. Do the people come first or do the businesses come first? I think Troy is an example where the businesses came first and the people followed with success. Albany downtown where I work, what we're experiencing is the people are coming, the businesses are the lag.

Why do you think that is?

Fariello: The taxes are part of the issue. Also parking. And that's being addressed in a positive manner. And I'd say the next up-and-coming area is Glens Falls. People are getting priced out of Saratoga Springs. They've recreated a nice downtown as far as retail and some office, however, and the people are coming. But I think as Saratoga gets pricier, you might see that become a destination point with an easy commute.

Allen: I think a lot of businesses will say we need some critical mass of residents. People complain that there's no real significant grocery store downtown. Are the people there to support it? So I can understand. And I guess there's now a smaller grocery store that has opened somewhere down there, but I don't know that that's ideal for what the city would like to see happen in terms more people living downtown. But it's a start. Obviously, Troy has made some real moves. I think there's a fair bit going on in downtown Albany. I know there have been projects in Glens Falls. Particularly, the people who are, I'll say, water sports enthusiasts, Glens Falls would be a great place to be. If you're working down this way and you can set your schedule so you're not on the Northway during the peak hours between exits 12 and 8, that probably would work for you.

Fariello: And the renaissance in Schenectady is also not to go without mention. I'll maybe use, not the word incredible, but positive and abrupt.

From all that you've seen happening, do you think that's going to continue to snowball in a good way?

Fariello: Yes. I think the focus on the casino site, the focus isn't the casino. It's everything else that's going up around. The casino is one moderate aspect of that entire site and what's been done over there. There's retail, office, apartments, direct water access. So it's a movement from the core of Schenectady out to a great piece of real estate as well.

Left to right: Daniel Fariello, Charles Cronin Jr., John Allen

KRISTINA WALSER

Cronin: I moved to Clifton Park from downtown Albany because the tax situation creates just a challenge for both people to live and people to work, because the rent just has to be higher to pay for the taxes. At some point, it breaks. And that's what's happening. It's challenging for the city. I'm not pointing fingers at them, but it's very challenging for them because they have the state of New York as a tenant, who doesn't pay rent.

At what point should we have an attorney involved when we're talking about financing or refinancing an asset or piece of property? At what point should we get you involved, John?

Allen: If a bank is working with a term sheet, an attorney should have a chance to review it and give some input there. Same thing with the commitment

MEET THE PANELISTS

JOHN L. ALLEN

Partner, Whiteman Osterman & Hanna

John Allen joined Whiteman Osterman & Hanna as a partner in January 2006 after nearly 20 years as a member of Shanley, Sweeney, Reilly & Allen P.C. His areas of expertise include commercial real estate financing, including construction loan financing and securitized financing for both borrowers and lenders; commercial leasing, including shopping centers and office buildings for landlords and tenants; and commercial real estate acquisitions, including land assemblages, and sales, including tax-deferred exchanges. Mr. Allen is admitted to practice in the State of New York, the Commonwealth of Massachusetts and U.S. District Court for the Northern District of New York. He is a member of the New York State and Albany County Bar Associations and has lectured on commercial real estate matters for continuing legal education programs. Mr. Allen also wrote a column on real estate for the *Albany Business Review* for nine years.

CHARLES M. CRONIN JR.

Founder, President, Licensed Real Estate Broker, Axiom Capital

Chuck Cronin is the President & Founder of Axiom Capital Corp., a commercial real estate (CRE) finance & advisory company headquartered in Clifton Park, New York, with a satellite office in Montclair, New Jersey. Throughout his career, Chuck has been involved in the structuring of more than $6.5 billion in CRE financing and more than $5 billion of whole loan portfolio evaluations, purchases, and sales. Prior to founding Axiom Capital Corp., Chuck served as president of Albany's National Savings Bank Association (NSBA), a publicly traded company on NASDAQ. As president, he directed NSBA's overall operations including asset liability management, mergers and acquisitions, security market sales, regulatory and rating agency compliance, and guided the sale of NSBA to KeyCorp. Chuck is an avid rugby supporter and a former Albany Knicks team member. In his spare time, he works with his wife, Monika, in many equine care efforts and enjoys raising horses. Chuck graduated magna cum laude with a bachelor's of science from Siena College.

DANIEL D. FARIELLO

Senior Commercial Real Estate Lender and Market Executive, Capital Bank

Dan Fariello is Senior Vice President and Albany Market Team Leader for Capital Bank, a division of Chemung Canal Trust Co. Dan has more than 16 years of commercial real estate (CRE) lending experience, focusing on all types of CRE, including: medical & office buildings, housing subdivisions, hotels, multi-family properties and retail complexes. Dan is a native of Saratoga Springs, a Skidmore College graduate and earned an MBA from the University of Massachusetts. He began his banking career with TD Bank, returning to the Albany area in 2004 as vice president with the CRE department of First Niagara, becoming one of their leading producers. In 2013 Dan joined Capital Bank as senior vice president, supervising the CRE lending team and as a member of the bank's senior loan committee. He is an active lender in the regional market, and was honored by the *Albany Business Review* as one of the Capital Region's 40 Under 40 community leaders. Dan resides in Saratoga County with his wife and two children.

letter. My experience, and I think most local banks are pretty good to work with, you're better off representing a borrower if you can negotiate things that you think the borrower needs no later than the commitment letter. The earlier the attorney gets involved, I think the better off the borrower is.

Cronin: I think the sooner you get the attorney involved, the better. I think even if we use retail as an example, the thought process has to be in the beginning when you're negotiating those leases. Even if you have your own family attorney, go find somebody like John Allen. Because you just wind up saving yourself a lot of money and time and aggravation.

If you're going to use an attorney, you should pick one that has the expertise in the field that you need. John, how does a letter of intent impact the process of negotiating a commercial lease?

Allen: My experience has been particularly with national tenants, and there are a number of what I would call tenant brokers. So there are some national companies that sign up with national tenants and try to find them locations. They will frequently use a letter of intent to spell out basic terms. Unfortunately, I think sometimes clients look at it and they see the last paragraph, which typically says, "This is not a binding agreement." And they think, "Well, OK, we really don't have to worry about anything. I'm a landlord, but this isn't binding." Try negotiating with the attorney for the national tenant something that is black and white in the letter of intent and your client doesn't want to do it. It's important that clients read them and understand that, while they're not legally binding, you don't want to be in a position where you just accept the things that you really don't want and then try to get them out of the lease stage.

Fariello: Same thing on the bank side with a term sheet. I'm a fan of a five- or six-page term sheet rather than a two-page term sheet. Just enough to spell out the basics. Let's get that figured out now rather than at the 11th hour when nobody's in an advantageous position. You win a battle but you lose a war.

How about the future effect of online shopping on retail real estate? How do you think that's affecting the brick and mortar?

Fariello: Plazas that have a grocery anchor, a lot of the fill-in now is what we call in the industry "food." It's quick-service restaurants, it's service industries. I was at a plaza recently. I looked across and saw a therapy center, a doctor's office, a lot of food, a chiropractor. You can't get that online. There's also the factor of T.J.Maxx, Marshalls, Tuesday Morning. It's adventure shopping where you don't know what you're going to find. I think at some point, online will plateau. Obviously, it will increase from where it is now, but at a certain point, eventually it will reach a saturation point. Tenants are merging – that's another factor.

Cronin: There will be a definite effect, but as Dan said, we're going to hit a plateau. I think whether it be a 14-year-old daughter or myself, while we may have different habits, she still wants to see the food that she's eating before she eats it. She does like to go to the mall and look at the clothes that she's going to put on. There's instant gratification and there's delayed gratification.

Allen: Dan touched on what's happening with doctor's offices now appearing in some of the strip centers and the tendency to fill space with food offerings. The landlord may not have negotiated its anchor lease with the grocery store. There are typically a lot of restrictions in one of those leases as to how much food there can be, particularly if it's takeout stuff. They're concerned with the proximity of those kinds of uses to their primary parking area.

Cronin: As we're talking about the internet, I think that that's a significant factor that comes into play with commercial real estate. Currently, on the internet, every day, I probably get 10 offers to invest in real estate. It's good in that it expands the universe of potential investments for individuals, but it's bad because people who are investing in those situations don't know, does that anchor tenant have a go-dark clause in the lease? Is there adequate parking? Are you going to be able to rebuild it in the event of a casualty or condemnation? … My concern with that is that you wind up with this pendulum situation where somebody's going to start losing a lot of money when interest rates change or whatever happens.

Do you think that it could be a major hit to the commercial market if the pendulum swings?

Cronin: I think you could have that. Not totally as a result of the internet, but too many people right now are searching for yield on investments. The problems are that it brings people who don't fully understand the risks and it creates many opportunities for fraud … The solution has got to be that people have got to pay attention.

Cronin: You look at the residential mortgage business right now. It's over-regulated. It's ridiculous. An example of that, where do I go to get my residential mortgage?

Fariello: To your local bank.

Cronin: Why? Because I don't have to go through the aggravation. I'm self-employed. I have four times the amount of cash in the bank that I'm going to need to spend on the house, but that doesn't matter. "Let's see a W-2." I don't have a W-2. I have a tax return.

Fariello: And that circles back to the relationship aspect of where we will do a lot of transactions. The relationship, again, fills in a certain spot versus going online.

When the Fed talks about interest rate increases, what does this mean? And what impact would a Fed interest rate increase have on the commercial real estate industry?

Cronin: The Fed regulates short-term rates. They regulate overnight borrowing between banks and they lend money to banks to balance their balance sheet. That's what the Fed does. So the Fed doesn't necessarily impact long-term rates. It's not as big of a deal as people make of it.

Do you think commercial real estate is experiencing a talent shortage?

Fariello: We see it. My managers and I harken back to the banking crisis in the late '80s and early '90s – banks had very strong formal training programs. Those were very quick to go. And those were people who would have graduated from those programs in the mid '90s. I graduated college in the late '90s, and there was almost a generation lost as far as upcoming bankers.

Cronin: In commercial real estate, there's a widening gap in the talent pool. And part of it is commercial real estate is something that you have to see. You just have to experience it. Probably the best way to learn the commercial real estate business is go through a disaster, because you don't understand the bloody noses that you're going to get until you get them.

Allen: Looking at the situation locally, if you look at it from the bank's perspective, you have banks that are really committed to commercial lending, commercial real estate lending specifically. You have others that aren't or haven't been traditionally. Then you look at things like the recent merger of First Niagara and Key. I don't think anyone knows what that's going to be.

So what do you think the answer is to the shrinking talent pool?

Fariello: It's getting people in the area. The population growth here in this area has been steady. There are assets in the market that make people want to move here: proximity to major cities, culture, arts, recreation. I moved back to this area. I grew up around here, moved out to the metropolitan Boston area, and moved back because you don't know what you have until it's gone. My top analyst is from central Massachusetts, so it's almost becoming an influx of people. We just hired an analyst recently that's local. So it truly is a mix of cultivating what you have locally, getting people back to the area that might have gone to college or relocated, and also finding new people coming in that are associated with other employment.

Anybody have anything else you want to make sure we cover here?

> *"It becomes a chicken or the egg. Do the people come first or do the businesses come first? I think Troy is an example where the businesses came first and the people followed with success."*
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> **DANIEL FARIELLO,** senior commercial real estate lender and market executive at Capital Bank, on recreating traditional downtowns

From left: moderator Marie Bettini of Albany Realty Group, Charles Cronin, John Allen, a court reporter and Daniel Fariello.

KRISTINA WALSER

Cronin: One of the things that is talked about frequently and has been asked a hundred times: Do we have too many hotels? Do we have too many apartments? I find that too much is communicated about supply and demand with respect to commercial real estate without there being an adequate forum for it. For example, people talk about, we have too many apartments. We don't have too many apartments. We're not spending enough time looking at the big issue, which is, what is supply and demand? And what we don't look at very often is, where are we starting from?

Fariello: Developers are bringing more apartment inventory online. Yes. However, we have been very active in that segment. And when you work with the right partner that is focused on multi-family development, that has an expertise in multi-family development, what we're seeing is not surprising. The new units are being absorbed quickly and they're being absorbed at the rents that they had demanded. Often times, we'll say with a new project, it will fill up, just at what rent? So we are doing a heavy level of sensitization.

What do you think is driving the quick absorption rate?

Fariello: It was a long time lack of, some would say, quality units. I would say personally, we had to rent an apartment for six months while our new home was being built. It was the best summer I had in years. I didn't have to mow the lawn. There was a garage. There was a pond I could take my children to. There was a swimming pool I didn't have to take care of. That gave me a great perspective as a financier.

Cronin: And the other thing is, if you sell your house today, are you going to sell it for more or less or the same as what you bought it for?

Fariello: Less. Without hesitation.

Cronin: My point is that the investment in a house and getting that appreciation that you saw from the '50s to now probably is not as prevalent going forward.

Fariello: Yet, I will say the homebuilder clients that we have are having record years.

Allen: How many of those homebuilders are marketing to first-time homebuyers?

Fariello: Not many.

Allen: I'm not sure that the person two, three, four years out of college has "Oh, I have to buy a house" as one of his or her priorities. A lot of people are working hard. They want to play hard. They don't want to maintain hard.

Fariello: This market, more than a lot of areas our size, has a core group of multi-generational family builders that have weathered multiple downturns. And the cream rose to the top. So the ones who have survived the numerous downturns in the past decades have managed their business well and know where to build the units and have focused their strategies and are successful as well.

Allen: I think if you're appealing to a market that already includes homeowners, unless you get to a point in your life where you really want to downsize and you want to simplify things, if you own a home, you're going to buy another one, whether you need more room or you like a location better.

Do you see developers talking about projects for the people that are downsizing?

Fariello: Yes. One large local homebuilder in particular is having great success with a smaller product marketed in the $200,000 to $250,000 range. The smaller footprint, maintenance included as an option, and they're having great success.

TRANSCRIPT LIGHTLY EDITED FOR SPACE AND CLARITY.