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Still distressed centers to acquire – but process can be stressful

by Ted Carter

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Conventional wisdom says opportunities to buy distressed retail centers have been erased by the slow but steady economic rebound of the nation and region.

An initial inspection of the retail landscape may support that thinking. But Bob Flowers, state director of the Alabama-Mississippi division of the International Council of Shopping Centers, thinks otherwise.

"We think things are coming back and recovering and that most of the distressed properties are gone –they are not," said Flowers, a Ridgeland commercial real estate broker and president of Wolf Ridge Properties.

The appetite for risking capital on them has not entirely disappeared, either, Flowers said.

"I have spoken to people in other parts of the country that like distressed properties."

Comvest Properties' D. Brooks Holstein likes them plenty. The Biloxi real estate investment firm for which he is a managing member has set up an entire separate business to raise capital for acquisitions of retail centers around the South whose owners are struggling with debt or have been hit with foreclosure.

Comvest has backers that include wealthy individuals as well as institutional investors. With the investment backing, Comvest builds stand-alone stores for retailers such as Walgreens, Office Depot and Starbucks and signs them to long-term leases. The Triple A credit quality of such tenants is attractive to the lenders Comvest pitches for backing shopping center deals, Holstein said.

"We use one to fund the other," he said.

Shopping center investors without the kind of cash-generating mechanism possessed by Comvest can seek bank money. You had better bring along a good bit of your own money, advised Flowers.

Flowers said banks have a built-in reluctance to double down on a center whose current owners are struggling to cover debt or perhaps have been foreclosed on. "It could be a requirement that you have a significant infusion of capital," he said. And some banks are requiring a debt service reserve to cover maintenance and renovations needed to attract strong tenants, he added.

Jackson real estate lawyer William Smith III said the shopping center buyers he represents in most instances have put up enough equity that lenders will come forward.

"Typically the lender wants 20 to 30 percent cash in the deal, if the center is dilapidated," said Smith of Watkins & Eager.

But each deal is different, he added, which makes that equity number "real fluid."

Smith said he has seen a few deals in which buyers acquired foreclosed shopping centers simply by taking over the debt.

Another obstacle, according to Smith, is that the prolonged recession has diminished the willingness of lenders to lend on both cash flow and underlying asset value.

For instance, today if you have 10 fast food restaurants with an underlying asset value of $10 million, the bank may only loan you $6 million. The time was, said Smith, that a cash-flow analysis could get you a loan of $13 million.

The bank's thinking, Smith said, is that "if there's a recession, the cash flow goes away."

It's "definitely shaken," he said of faith banks once had in cash flow.

"That's where you have to have high-net-worth investors and institutional investors who want a good return on their money," he added.

Regardless of the source of capital, the parties involved in salvaging a distressed retail center must have patience to spare, advised Flowers. "You're not going to go in there and turn it around quickly."

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