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Some Concern for Commercial Real Estate Following Wall Street Shakeup, Analysts Say

By Allen Kenney

The recent demise of two major investment banks within 24 hours likely will raise a variety of issues for the commercial real estate industry, according to analysts.

Lehman Brothers Holdings Inc. announced on Sept. 15 that it had filed for Chapter 11 bankruptcy. At the same time, Bank of America announced that it had reached a deal to acquire longtime Wall Street institution Merrill Lynch for $50 billion.

Ross Moore, Colliers International's executive vice president and director of market and economic research, said Lehman's story had "many different facets" that touched on a number of areas within commercial real estate, ranging from investor confidence to pockets of vacancies within the New York office market.

One of the Greats

"I don't think there's anything positive to be taken from a great company like Lehman Brothers going out of business," said Ken Rosen, chairman of Rosen Consulting Group.

Moore contended that the greatest effect of Lehman's announcement could be its psychological impact on the financial sector. Lehman's folding provides another serious blow to an already flailing market, especially when coupled with the fall of Merrill Lynch and news that insurance company American International Group (AIG) was considering a major reorganization, according to Moore.

"It's clearly not good news. You're losing another debt and equity player," he said. "More importantly, it's going to shake up confidence again, which, in our business, is a critical ingredient."

Brad Case, NAREIT vice president, research and industry information, said this psychological effect shouldn't encompass REITs and other listed real estate companies. However, they may suffer some "collateral damage," as investors in financial sector mutual funds and ETFs sell their holdings, taking REITs down with them, according to Case.

Moore noted that Lehman's exit from the deal-making scene meant one less source of liquidity would be available in an already tight market. The likely outcome would be higher capitalization rates and the prolonging of the real estate industry's current downturn.

Liquidation Pricing

Lehman's bankruptcy declaration also raises the likelihood that significant portions of its assets will be sold. The investment bank's commercial real estate holdings include interests in assets acquired when Lehman teamed with Tishman Speyer Properties in 2007 to buy apartment REIT Archstone-Smith for $22 billion.

Jerry Monash, executive director of investment services for NAI Global, downplayed the idea of a "wholesale liquidation" of Lehman's $32.6 billion real estate portfolio that would drive down pricing across the board.

"I don't think this is going to dramatically affect the commercial real estate industry," said Monash, who pointed out that most of Lehman's real estate holdings were specific to certain markets and sub-sectors. "It's significant from the respect that Lehman is a major player and has been a major player, but it's not necessarily such a significant event that it will reduce property values throughout the country."

On the other hand, Case said a spate of sales could provide "hard information" on the values of properties held by other investors, such as private equity funds, who have yet to recognize losses that have already happened.

New York Effect

Analysts also observed that, as a renter of office space, Lehman's demise could add to current woes in New York's commercial property, where the upheaval in the financial services industry already has brought about increased vacancies. Office REITs with a focus on New York fell sharply during trading in the wake of the news.

SL Green Realty Corp. (NYSE: SLG) slid 20 percent on Sept. 15, with shares prices falling $17.60 to end the day trading at $70.46. Shares of Vornado Realty Trust (NYSE: VNO) were down 15 percent, falling $15.14 to finish at $88.70.

Rosen, however, characterized any such immediate drop in the share prices of companies with significant New York assets as an "overreaction."

"New York real estate hasn't become 10 percent less valuable all of the sudden," he said.