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OPPORTUNITY LIFT-OUT

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A SMORGASBORD!
\$200 BILLION
OF DISTRESSED
OPPORTUNITIES

YOUR QUESTIONS
ANSWERED
LISTING ON
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INSIDE INFORMATION
HOW TO
PICK A
GREAT
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\$200 Billion **of Distressed** **Opportunities –** **A Smorgasbord!**

By R. Brian Watson



Northstar Commercial Partners recent industrial acquisition - Houston, TX



Northstar Commercial Partners recent office acquisition - Denver, CO

■ THIS is the time for an unprecedented opportunity to practice value investing in commercial real estate (CRE). One of my favorite investment philosophies is a statement made by Warren Buffet, who tells us that we should “be greedy when others are fearful.” This is truly the case in the CRE sector as many financial institutions and owners need to de-lever their positions and shed liabilities associated within this asset class.

Currently, there is an estimated \$200 billion of distressed CRE assets in the United States. Though most of these “problem assets” are made up of retail and hospitality properties, lenders lump all commercial assets into one stigmatized asset class. For example, industrial real estate is currently the least affected asset class with only \$5 billion of distressed debt. In most core cities the industrial vacancy rate is less than 10%, which is much healthier than other property types. At Northstar Commercial Partners (“NCP”), which I founded over 10 years ago, we specialize in acquiring distressed real estate assets that have been labelled as “troubled assets,” but focus on properties whose true market demand has not been negatively affected. For instance, we recently acquired a 370,000 SF Class A warehouse building in Houston. The lender took a huge write-down on this asset for our acquisition, even though the vacancy rate in Houston for similar space is less than 7%. We take advantage of lender issues, rather than market demand issues. Buying quality real estate with “good bones” at distressed discounted prices is our primary objective.

Though most real estate companies are talking about potential investment opportunities, NCP is actively acquiring assets for pennies on the dollar (usually 25% or less of replacement cost). The primary vehicle we use is an Accredited Investor Fund that allows us to demonstrate our ability and flexibility to close in a timely manner. We are still accepting investors in this Fund, and are happy to answer any questions you may have.

We believe that the CRE market will continue to bottom out through 1st Quarter

2011. This is mainly due to the timing of when most CRE mortgages were put into place, as these mortgages are now coming due. Though lenders try to “pretend and extend,” regional and local banks have experienced tremendous pressure on their books from CRE exposure. These assets constitute a larger portion of their portfolios and unlike larger institutions, they cannot wait out the downturn. Consequently, these smaller institutions must sell a few assets very quickly as each quarter nears an end, and a buyer must be ready and able to “pull the trigger” quickly to take advantage of these prime opportunities.

So, when is the time to buy?

As stated above, we believe that the bottom of the CRE market will be reached within 12 months. Given the current uncertainty in the marketplace, there is a constriction of capital from debt and equity sources. Though there is a lot of “dry equity powder” ready to be put into action, this money is waiting until the bottom of the market is announced. Once the mainstream media announces that we have reached the bottom, history would tell us that we have already bumped up 15 - 30%, and have thus missed the true rock-bottom deals. Given this, NCP believes that now through 2nd Quarter 2011 is a phenomenal time to troll for deals. Practicing patience and prudence is imperative in this economy to source the best deals, but once these are found you must be prepared to act. At NCP, we practice these three Ps, and that is how we continue to generate strong returns to our capital partners.

Product Type and Market

Since this economy will allow you to buy such great value at steeply discounted prices, we believe you should be selective concerning product type and geography. NCP focuses on core markets with a positive future such as Seattle, Southern California, Houston, Denver and Chicago, with a secondary focus on Atlanta, Nashville and Salt Lake City. The primary product type of choice is industrial warehouse, with office in a secondary position. However,

we will also acquire deeply distressed retail and development deals. For example, we recently acquired three former Albertsons grocery stores for \$14.00/SF. By acquiring and selling one of these assets on the same day, we reduced our basis in the remaining two properties to \$9.25/SF. This acquisition was less than 10% of the \$90 - \$100/SF replacement cost for these assets. In another example, we recently acquired a six-story, 205,000 SF office building for 12% of replacement cost (\$23/SF; \$4.6 million). This was normally a \$35 million asset on a replacement cost basis, however the owner needed to sell immediately. We are now working with several users who will turn this property back into a \$25 - \$30 million value once a lease is signed. Buying assets at these pricing levels provides a strong position to beat out the competition given our lower basis. The old adage of “making your money on the buy” is very true of the CRE market today. In a market with continuing inflation, CRE will also act as a strong inflationary investment hedge.

To quote Founding Father Thomas Paine: “These are the times that try men’s souls.” But these times can also be the times that build men’s wealth. We look forward to building your wealth alongside our investments in this truly opportunistic buying environment. ■



R. Brian Watson founded the highly successful Northstar Commercial Partners in 2000. Prior to this he joined Cushman & Wakefield, after receiving his degree in Real Estate from the University of Colorado at Boulder.

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