

Tulsa Roundtable: Weighing the positives vs. the negatives

by Kirby Lee Davis

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After three years of recessionary malaise, it seemed like a good Tulsa Roundtable topic to ask what surprises lie ahead in commercial real estate, with the national economy on the mend.

But that assumed everyone agreed with that assessment, among other things.

"The topic here is always a tough one because it's asking us to see the future," said moderator Mendy Parish, a retail specialist with CB Richard Ellis of Oklahoma.

So she posed the question to Sean Kouplen, president and chief executive of Tulsa's Regent Bank, who joined her on the June roundtable with NAI Commercial Properties' broker Monty Berry, CBRE newcomer Caitlyn Bailey, Grubb and Ellis Levy Beffort multifamily broker Gary Krisman, National Commercial Auctioneers founder Stephen Karbelk, and HotelBrokerOne Tulsa market manager Mike Craddock.

That's roughly when the debate began.

Kouplen: "I think things are improving significantly. If I would view a crystal ball for the next year, I think what you're finding is our competitors are loosening up. They're loaning money. We're seeing more competition on quality deals than we have seen in two years. And that's for two reasons. One is, banks have no good place to alternatively invest their deposits. So when you bring in deposits, if you can't loan them out right now, interest rates are so low, you just don't have a good alternative source. So you're very motivated to find good loans. Owner-occupied (commercial real estate) is going to continue to be very strong. Owner-occupied financing, a company that is buying a building for their use, has been strong and will continue to be strong. You'll have no problem finding financing. The problem is going to continue to come in getting financing for more speculative projects. But as the economy improves I've noticed our loan committee feels better. I've talked to friends in the industry; they're feeling better. So I think the surprise is going to be, this next 12 months are going to be better than what we all think."

Parish: "One of the things that I've noticed is that in the commercial real estate sector, I'm actually getting calls from bankers saying, 'Hey, we're lending again. We're interested. If you have somebody who wants a loan...' Is that for the same reason?"

Craddock: "I've haven't heard that call. I haven't got those calls in hospitality!"

Kouplen: "Well..."

Berry: "You're stuck in hospitality now, Mike!"

Kouplen: "It very much depends on the sector, in my opinion. Hospitality's a sector that's grown so rapidly, it's a little nervous. You look at the supply versus the demand and you look at the occupancy, that's a little tougher. Retail's a little tougher."

Parish: "Yes!"

Kouplen: "Office, medical, those types of projects are much easier. But even in hospitality, we've made four new hotel loans this year. If it's to the right operator and the right project, and it makes sense, to answer your question, I think it's for the same reasons. We all need to get money out, and again, you couple that with the fact that you're just feeling better. Our business is like yours. It's an emotional business. When you sit at a table like this, and you look at a request and you're trying to see the future, and if every headline over the last two months has been negative and everything looks like it's going in that direction, you're just not quite as excited about jumping out there and putting your capital at risk. The local headlines have not

been negative. They've been very positive. And so that just makes everyone feel better."

Parish: "So one of the surprises you think, if I heard you correctly, there will be more lending for some of the more risky, 'out there' proposals?"

Kouplen: "There will be. No question. There will be."

Perception vs. reality

Parish: "Monty, I guess the same question for you. What do you see as some of the major surprises over the next 12 months?"

Berry: "Well, to kind of go off of his explanation, I do see that we have kind of returned more to fundamentals, as we have been, and creating more of a positive perception. The banks more or less kind of control the roost, if you will, and a lot of the activity that we do day in and day out. But when we talk to a lot of buyers and sellers, again, there continues to be a real gap, unrealistic expectations, about trying to meet price levels. But along with that, it's whether or not the borrower can even get qualified. Many of them go in with uncertainty, a lack of confidence. But it's really just trying to get them back to a level where they see that the banks will loan. It's really a perception battle right now."

Craddock: "Is it perception or is it reality? Reality means the sellers are not dropping their prices, the buyers are not raising their prices, so in my opinion it's more reality."

Berry: "It is more reality, but getting to reality, too, because perception is still that it's really distressed. OK, I should be able to buy this at this amount, versus this. Of course many people – I guess a lot of sellers, today – are still living in the 2006, '05, '07 models, when there was overinflated pricing. I mean, let's be realistic."

Parish: "Absolutely."

Berry: "So returning to fundamentals, I think it's so important that reception and reality is where we have to get more of a balance."

Craddock: "I agree with you. When I look at hospitality and where we are right now, especially in the Tulsa market, our average day rate, we have actually gone up in Tulsa. Our occupancy rate has actually gone down, but from an operational standpoint we're still doing pretty well. So fundamentally those criteria have not changed. So you go to a lender and you hear the world 'hospitality' and they just don't let you in the door. The perception is that hospitality's worse but it's actually not from an operational standpoint."

Kouplen: "And I think, again, that's largely because the number of new projects. I honestly don't believe that it's necessarily the industry numbers being bad. It's just that when you look at the number of new projects that have come into the market, there is just a fear – and I think it's a legitimate concern – that we could get overbuilt at some point. And you don't want to be the one who made the loan on the project that is overbuilt, you know? That doesn't meet those perceptions that you're trying to reach."

Craddock: "Uh-hum. But Monty's talking about perceptions. I think that's where perception is not reality."

Downtown's doing better?

Karbelk: "Don't you think our market needs more hotels for getting bigger conferences, to support the significant redevelopment downtown?"

Craddock: "Did you just join the chamber?"

Karbelk (over laughter): "You think about this whole vision of developing downtown and doing all this, but there's still not enough beds to get the big conferences to come into Tulsa. It's an easy city, centrally located, and so there is a problem there."

Kouplen: "The occupancy of the downtown properties would not prove that. Mike, tell me if you agree."

Craddock: "You're right."

Kouplen: "The occupancy of Tulsa as a whole is very good. But there is capacity downtown now. I looked at a very interesting downtown project probably a month ago. But when you looked at the way the other downtown properties performed ... they're not doing poorly, I'm not saying that, but there is clearly capacity there."

Krisman: "If you look at the downtown office sector, there's some real bad news and there's some real good news. We have one major owner that is losing tenants and occupancy and –"

Berry: "Shutting down buildings."

Krisman: "Shutting down buildings now."

Parish: "Mothballing...."

Krisman: "Uh-hum. And then you've got the One Place project, just east of the BOK Center, that's going to be magnificent. We put Northwestern Mutual Insurance down there, so it's going to be them and Cimarex Energy. That's really going to be something. It's interesting; Northwestern was so excited about being a part of the redevelopment downtown. They had lots of good options, but they just kept their eyes on the ball and that's where they wound up."

Craddock: "Especially for someone of their caliber and size. It's definitely a tenant's dream to be able to name what you want."

Krisman: "So I see us at kind of a period of adjustment in this market overall. We're having good news, and when you read the paper and watch the news, and when you have good news, you feel better about doing things. Oil companies, insurance companies, all these guys are moving up their space and making longer-term commitments, improving their quality."

Berry: "The concept that's been bantered around so many different conferences is flight to quality. These kind of groups, tenants, are looking for good, quality projects to be a part of. Downtown probably suffers more as a result of one large ownership that is in disarray, so to speak. But in terms of occupancy, I think that comes into perspective more to the banks in looking to whether we can create a good loan opportunity. Downtown is kind of a mixed bag when looking at different sectors, but generally at a whole I think the office market's pretty stable."

Karbelk: "I lived downtown. When I moved here I had an office at the Philtower, and I remember going down on a Sunday to work, and there's literally kids riding their bikes in the street because there's no cars and there's no place to go walk and get a soda on a Sunday at 2 p.m. unless you go all the way over to the Mayo. I just see in so many other markets where the downtown's just dying. Kind of my perspective, since I'm not a Tulsan, is you've got all these little fiefdoms building up. You've got the Bixby fiefdom, and Jenks, and Broken Arrow, Owasso. And you look at the population growth. That's where the population growth is, and since 2000, Tulsa's gone down negative 2 percent versus Jenks is up 65 percent, Bixby up 50 percent. And then you have all these big projects being built and, if you're like me, 'Why am I driving downtown when I can just literally drive across the street from my house and have a perfectly nice office and live within a one mile block and have everything I need?' I think there's tension there."

Kouplen: "There's some residential in the works down there."

Parish: "There's about 1,700 units and that's, what? Thirty-three percent higher? There has been a movement –"

Karbelk: "It's slow."

Krisman: "There have been things happening."

Craddock: "My question is, to jump on that, though, my understanding is, from what I've seen, especially from the Mayo, because there is a hotel and apartment mix, and I'm pretty tied in with those guys, the occupancy on the housing rental units in downtown Tulsa seems to be fairly high."

Parish: "Very high."

Craddock: "That is my perception. I don't make that what the reality is."

Parish: "I believe that that's true."

Krisman: "I think that's true. My personal opinion is we need more of what we all consider typical Class A multifamily instead of building conversions to lofts. Because with most of these you still have a parking issue. So, American Residential's Renaissance downtown ... full all the time. Absolutely full all the time. And they're expanding their lofts."

Karbelk: "The people that like those lofts are the young professionals, and they can't afford that. Housing's not that expensive. Why am I going to go buy a loft for a couple hundred thousand dollars when I can literally have a nice house – "

Krisman: "Nobody's selling any. There is not a market for that."

Parish: "You can rent them."

Krisman: "There is not a buyer's market. We haven't seen it yet. We've tried, and it didn't work."

Craddock: "I think that's OK, because the rental units get people down there quicker."

Krisman: "Yeah."

Craddock: "So you get them down there quicker, you get more people down there, so you then start creating that energy down there that people want to be down there and are down there, which is going to bring the retail."

Berry: "It's still a fringe area, too."

Krisman: "I think downtown, we're doing a good job of making it become a destination point. If you live in Denver, if you're a Caitlyn, or Monty ... I mean, the younger guys..."

Craddock: "Watch where you're going with that age thing."

Krisman (over laughter): "I mean.... "

Berry (after laughter dies down): "I want to add to what Gary's talking about, too. I guess we somehow got focused on downtown, but we're forgetting that Kaiser, George Kaiser ... there's a group of investors, the community patrons, that have really been strong supporters of downtown and of Tulsa. They're making a significant investment into. There's a lot of energy going in. Is that going to attract or bring in residents right now? Not necessarily. But also don't forget about River Parks. That a natural extension right there. You look at all the development potential. I know Kaiser's got plans there at the Blair mansion. That should all come into reality within five years and should kind of bring more of a funnel effect downtown. And so I put my faith in George, GBK, he's..."

Craddock: "Paid political announcement."

Krisman (after laughter): "GBK's my initials, by the way."

Berry: "That's what I mean! (after laughter) But there's a lot of investment and support by large philanthropists and we're very fortunate to have those people."

Doing nothing

Kouplen: "One challenge that you have in looking more global economically is that you have such a different viewpoint locally versus nationally. So you wonder if the challenges nationally – unemployment, federal government, health care, concerns about inflation, pick one – is that going to begin to impact us locally? And I think that's what we see locally. And I think that's what we see when we're talking to them. They feel good about Tulsa."

Parish: "We don't live in a bubble."

Kouplen: "But we don't live in a bubble. And so the question is will our strength in oil and gas and in our local economy outweigh the negative influences we're seeing or will the federal government get their act together, and I don't think there's any chance of happening anytime

soon. So psychologically that seems to be what I'm seeing with our clients. They're struggling. They want to believe the good but then they watch the morning news and read the Wall Street (Journal) and it's just tough."

Karbelk: "There's the part of them that says, 'I just want 20 acres and a garden and I don't want to talk to anybody. Let me know when it's over.' (laughs) I get worried about it in the auction business when I don't know what the headlines are going to be the morning of an auction. The stock market went down, something crazy happened and people will just lose confidence in a snap and just decide, 'I want to wait.' And I think that is a big change, both Tulsa and everywhere. There doesn't seem to be any risk in waiting. You don't have to get the deal right now because there's still more deals."

Berry: "If they do nothing – "

Karbelk: "Doing nothing is very much a strategy."

Parish: "That's exactly what I had written down."

Karbelk: "If you've got a lot of cash you can do nothing. The only thing that would drive someone to buy a deal is because they're approved by a bank and that's the only bank that would approve them and they have to do it if they want to buy anything. If they're an all-cash buyer they're going to sit."

Parish: "I was glad to hear you're on this committee to talk today because I think auctions are something we really haven't dealt with in the past and all of a sudden you guys are in our face, and – "

Karbelk (grins slyly): "Sorry."

Parish (working through smile): "And the reality is – "

Craddock: "I would never say that."

Karbelk (laughing): "To your face?"

Craddock and Berry: "To your face!"

Kouplen (over Parish's laughter): "That's so very confrontational! Very!"

Karbelk (through everyone's laughter): "I'm just a broker that sells at auction. That's all I am! That's how I make deals!"

Parish: "We've had auctions and it's been around the periphery but now if we don't have things that sell in this time it's going to auction so that's something we're dealing with more and more, so how do you see your business change, and again, back to the future, so you see it's going to increase? Because that's the single biggest thing, other than a disconnect, is the fact that I have so many properties that are waiting in limbo. They're not pouring back out into the market and I think they needed to. Had they gone back into the market I think we'd all be feeling a little better right now, but I can't tell you how many properties I have that are in that limbo stage."

Craddock: "The extend and pretend?"

Parish: "Extend and pretend."

Of auctions and values

Karbelk: "We keep adding staff. I'm up to 22 people now."

Parish: "And that compares to how many last year?"

Karbelk: "Double. I started the company two years ago. We'll hit \$100 million this year in sales, just for our company. That's just counting single sides. That's not double-counting."

Craddock (smiles): "I bet."

Karbelk: "Seriously! We've sold over 100 properties in the last 30 days, so you're going to hit

some numbers.”

Parish: “Locally?”

Karbelk: “No. We’ve sold in 18 states so far – well, probably 10 states – so far this year. I’ll share an example. Last Friday we did an auction, a project in Kansas City that was 14 partially finished homes. These were in the price point of \$380,000 to \$400,000, finished. Downtown project. We were selling for a bank who acquired a bank from the FDIC. There was 10 of them that were about 50-percent finished and there was four that were about 80-percent finished. We pre-sold three, and so we went to auction with 11. And what we were originally going to do was, the ones that were 50-percent finished, we thought we were just going to sell them off bulk. One bid buys them all. And at property inspections we were getting interest from all these individuals saying, ‘I want to buy just one.’ We didn’t think a consumer would be willing to take on a 50-percent finished house. Lo and behold, they were all over it, with cash, ready to buy, because they realized they could create value. We ended up selling all of them and we ended up getting about \$100,000 to \$105,000 a unit, keeping in mind that finished, they were \$400,000 a unit. But they were only selling one to two a year. They weren’t really moving. They were just kind of sitting there.”

Parish: “Don’t know what the value is.”

Karbelk: “We ended up having 28 registered bidders and we cleared it. And we think it was absolutely the right thing to do because, who wants to have a house with a vacant house on either side of you? Literally one time I walked in and there was a homeless person’s stuff there and they were getting broken in to. Right now we just work with banks and bankruptcy courts. We do very, very little work for individuals. And the reason is, and you talk about people just sitting on the sidelines, I think for the investors, the private owners are competing against the bank properties and they’re competing against those opportunities. And I don’t think the commercial investor really cares too much if it’s an office building or if it’s retail or if it’s multifamily, if they can buy it right, find the right person to manage it for them, create value, sell it in five years, that’s what they’re doing. They’re paying cash, they’re closing in 15 days, they’re using ordinary financing but it’s like 50 percent down, they’ve already been approved, they’ve already got the relationship. But on that deal, 12 of the 14 transactions had a broker representing the high bidder. We pay usually between 2 or 3 percent except if it’s Mike.”

Craddock (smiling): “Uh-hum.”

Berry: “Five or 6.”

Karbelk: “Unlike a lot of auction companies, we’ll pay. We’re members of the board, we want that. The brokers are among the buyers because the buyers are saying, that’s what I want to buy. I want a chance to get a really good deal.”

Set and hope or sell and lose

Berry: “So of all the ones you’ve been working on primarily what’s the major sector you’re seeing in terms of sales.”

Craddock: “What class of asset?”

Karbelk: “Last year was hospitality. Mike and I actually did some deals last year. This year it’s all been just B and C bank assets. It’s just people giving deals back. They can’t sell them. The single most difficult asset class for us to sell, and we turn down more on, is commercial land. Commercial development land is an oxymoron. You can’t sell it unless you just want to sell it on 10 cents on the dollar and stop paying the taxes.”

Berry: “I just hit ‘delete’ when they broadcast that.”

Karbelk: “Why tie your money up in a commercial develop property when you can buy a 40-percent occupied hotel, rebrand it, get it up to 70 or 80 percent and literally triple your money?”

Kouplen (shaking his head): “The turn’s too long!”

Parish (to Kouplen): “And so, for the next year, are you seeing much in the way of land development?”

Kouplen: "No."

Berry: "No."

Karbelk: "They're not going to sell. You can even do seller financing, but people don't want to tie up all their cash in one deal because they're afraid Gary or Monty's going to call them and say, 'I've got a deal you've got to buy right now.'"

Kouplen: "And you've already used up your money."

Karbelk: "And you've already used up your money. And you're like, 'Ugh!' It's like the fear of, I just always want to be ready. Well, if you're always ready, it means you're not going to pull the trigger."

Parish: "Personally, I'm glad to see some of this flush out of the market. I'm ready for it all to get out there and let's deal with it and then let's get on with getting some normalization of values, because until stuff sells, the disconnect continues. We are not seeing what we expected to see, Sean, which is a whole bunch of distressed stuff come back out and the second or third buyer in get to a level that makes sense."

Craddock: "We've also been told that all of those assets are 'there.' Where 'there' is, I'm still not sure. But I agree. That has to happen. You've got to get all those assets repriced and on the market and get them dumped because they are dragging down the market."

Parish: "Because that doesn't help us with buyers and sellers to get them back on the market."

Kouplen: "The challenge is, the shedding of those assets represents a financial loss for the bank, which they do not want to realize. And so you would rather set and hope ... you've got an appraisal which will allow you to keep it on your books at a certain value and you really don't want to realize that loss. That's part of it."

Craddock: "I've been told that's a huge part of it."

Parish: "There's such a dramatic difference. It's not this ... it's this."

Berry: "The question is, have we really reached an equilibrium?"

Parish: "Because I'm not feeling it."

Krisman: "In multifamily you're going to see a huge portfolio come out, the Remy stuff. It's going to be mid-\$15,000 a door."

Berry: "A door?"

Krisman: "Well, it's a 25-percent-occupied portfolio."

Berry (smiling): "And those are A quality..."

Krisman: "No, no, no. (laughter) They're at best high C. Some of them are bills paid. Whoever buys that really has to know what they're doing or they'll lose, because it's a tough turn. On the other hand, if I've got a quality complex ... I just sold one on a 7 cap, on real numbers. The people buying it are delighted, and the people selling it are delighted. And that's Tulsa, Oklahoma. I can't tell you of all the people chasing quality assets. Local and even out of state. The coasties stayed away for a long time and they're back because they're getting hammered where they are."

Something's got to happen

Parish: "Do you see any of this, Sean, coming through in the next year, or do you think it's extended beyond that?"

Kouplen: "I think it's probably extended beyond that."

Parish: "I'm not an economist, but I think that's really going to keep us from really tipping the scale."

Kouplen: "I think you'll see a steady trickle. I think you'll see banks let those properties go as they can afford to. I just don't think you'll see them all because you're trying to manage liquidity, you're trying to manage earnings, you're trying to manage your regulatory ratings. It's just not as simple as opening the floodgates and letting it go."

Craddock: "Because if you did, if you repriced all those assets where the market is and had them write down by that difference, how many more bank failures would there be? A massive amount."

Kouplen: "I don't know that you would have a lot of local failures, but you would have a lot of local downgrades, regulatory action, which impacts your ability to operate. So it's a balancing act. If I could kind of share one message with the business community on the banking front, it's really about cash flow. It really is about cash flow. The days of I can buy this and turn it and sell it, they just are not there. There just is not the confidence to do that unless you've got a huge balance sheet, a very strong backer that can hold it a long time. It really does boil down to cash flow."

Craddock: "Or the lack thereof."

Kouplen: "Or the lack thereof. And I don't think that's going to change for a while."

Parish: "So some of those troubled assets that are out there in that hold period, they're going to have to get to a price where they cash flow based on the purchase price."

Kouplen: "Exactly."

Craddock: "And that's where Monty's talking about, the disconnect, the disconnect being, the seller still arguing I want it up here, but the cash flow says it needs to be down here ... something's got to happen."

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