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It's What's Inside That Counts

As teenagers, we all became too familiar with the saying “Beauty is only skin deep; it's what's inside that counts.” While at the time that didn't always offer us much consolation, it was an important lesson that we learned as we grew up. This same lesson holds true for real estate. The exterior of a property gives us a first impression, and while the quality and upkeep of the landscaping, paving, façade, and signage will often attract tenants and customers once, it may not bring them back.

Translating this saying to CMBS affirms the need for comprehensive site inspections. When rating a transaction, inspecting the physical real estate and its market are key components to DBRS's due diligence process. Beyond determining whether the property actually exists, a site inspection will indicate whether the property possesses physical characteristics to compete within its market, based on its ability to meet the needs of current and future tenants. Simply driving by a property will not tell the whole story. One must look inside to determine the functionality and desirability of a property.

A site inspection should include an assessment of both the exterior and interior conditions of a property. The interior design, improvement quality, lighting, and overall functionality will retain tenants and keep customers coming back. Below are items to look for inside the four main property types.

Industrial/Office:

Industrial buildings need to be well-designed with sufficient column spacing for the mobility of transporting equipment such as fork lifts. In addition, ceiling clear heights must be tall enough to allow for racking systems or manufacturing equipment. Office properties, like industrial, can be impressive from the outside and yet be quite obsolete on the inside. The ideal, most functional space is relatively unobstructed by columns or pillars to allow the space to be easily subdivided based on tenant needs. The condition and quality of the improvements will determine the type and quality of new tenants.

Retail:

To get a complete understanding of retail properties, one needs to shop the stores within the center. The merchandise must appeal to the surrounding demographics and the space should create a pleasant shopping experience. Adequate lighting, stocked shelves, and alluring displays help keep customers coming back. Space with poor street frontage and depth will be difficult if not impossible to lease. The fretted L-shaped design also suffers from “dead” elbow space with limited traffic.

Multifamily:

Touring a multifamily property can expose concerns that would not otherwise be apparent. The professionalism of the management and the profile of the typical renter are clues into the turnover rates that can be expected. The desirability of the property will depend greatly on the interior of the units—the size, layout, and amenities—as compared to the competition.

While the exterior can tell you much about a building, driving by will not provide a good indication of the sustainability of the cash flow and the future performance of a property. Meeting with management, a leasing or borrower representative, or a local broker gains you access to assets with heightened security and often more insights into the local market. To DBRS, a property inspection includes stepping inside the real estate; after all, “Beauty is only skin deep; it's what's inside that counts.”

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