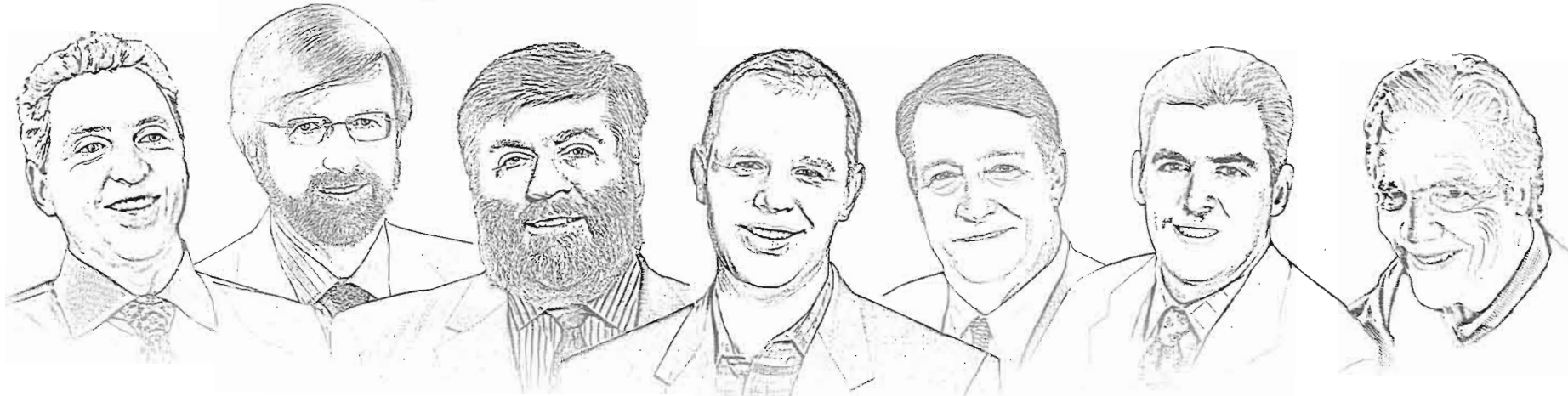


“Son, when I was your age...”

Long-time real estate professionals reflect on past downturns and lessons to be learned.

By **Mary Duan**



Michael Scribner

Tim Tosta

Dan Huntsman

Arne Ericson

Tom Hart

Mike Brown

Charles “Chop” Keenan

Developer and real estate investor Charles “Chop” Keenan has been in the real estate business so long that he was too young to understand the implications of his first downturn. “I was so young I didn’t realize what was going on,” he says. From the boom-busts of 1973 to 1975, ’80 to ’82, ’90 to ’91 and culminating in the dot-com bubble’s magnificent burst in 2001, Keenan has learned that short or uncovered debt can be deadly in a downdraft.

“Those are the guys who get carried out,” says Keenan, principal of Palo Alto-based Keenan Land Co.

It’s also why, four years ago, Keenan stopped building altogether. He manages his company’s R&D and office portfolio (ask how many square feet exactly, and Keenan says he’s not sure) and waits.

“Four years ago, I didn’t build ... and it made me a dinosaur,” Keenan says. “There’s no explaining it exactly. I couldn’t get enough returns to make a deal worth the risk. Sometimes a long memory hurts you in doing new deals, but it can also help you.”

The cave-in of the financial sector and the current recession have profoundly eroded the foundation of San Francisco’s real estate market. These are hard times for developers, contractors, architects and real estate lawyers, but veterans of previous downturns are relying on their past experiences to pull them through this phase, and their advice may be the only thing in the real estate sector that isn’t rapidly depreciating in value.

Keenan is waiting for lease rates to comport with new construction.

“I’ve seen 50 percent retrenchments, and you don’t want to be in the business of underwriting leases,” Keenan says. “Everything real estate is about starts with the transaction. Everything turns from that friction point.

“When business needs space because it’s growing, that’s a sign,” he says. “Leases or sales that drive profits. That’s a sign.”

At Shorenstein Properties LLC, executive vice president Tom Hart, an industry veteran with more than 35 years experience, points out that real estate “is an operating sport, but many people made it a financial engineering sport, along with all of the other financial engineering being done on Wall Street.”

Because of the company’s view of its function—that Shorenstein is

fundamentally a real estate operating company—Shorenstein holds its operating capabilities close, a move that Hart says enables the company to achieve superior results.

“Companies that have that operating capability are better off than those that are purely financial in nature,” Hart says. “Having come from an orientation of knowing how to lease and the dynamics of rising and declining markets, we can manage that function better than other asset managers.”

What Shorenstein has learned as it transformed from a regional player to a national powerhouse is the need to maintain reasonable leverage, “lower than what has been worked with in the time since the dot-com bust.

Shorenstein’s position, “60 percent leveraged,” has enabled the company to avoid deleveraging less than its competitors, Hart says.

Dan Huntsman, an architect with more than 30 years experience in the Bay Area, says, like many, he was surprised by the speed with which a booming market crumbled into recession. But he adds that there is work to be done before the San Francisco market recovers.

“I’d have to describe this downturn as strange,” says Huntsman, who is the founding principal and president of the Huntsman Architectural Group. “It has been so cataclysmic and came on so fast, but at the same time there is a lot to be done. Companies should be looking to positioning themselves for several years down the road. If there is anything to be learned from past cycles it is that those people who do the best job planning ahead are the same people that come out ahead.”

Michael Scribner, president & CEO of San Francisco-based BCCI Construction Company, has been in business more than 23 years. While this downturn is unlike any he’s ever experienced, he says that BCCI’s culture focuses on rigorous planning and communication, and it’s that foresight and openness he hopes will see his company through.

“It’s even more important when you go into a downturn to really plan. You don’t want to overreact and start cutting headcount without being thoughtful about it,” Scribner says. “And there’s so much anxiety about the economy and cutbacks and layoffs, you want to make sure people really know and understand that there’s a plan A and B and C.”

Otherwise, employees can become so insecure that productivity falters and they have a tendency to start looking elsewhere, he says.

BCCI's work includes everything from tenant improvements at aging office parks to new headquarters for biotech companies. Because the company does so much large corporate work, it tracks leading economic indicators, so it has a constant bead on employment and manufacturing statistics. The company also tracks what its partners in the leasing and architectural community are doing.

"There's so much uncertainty around this one, it's a matter of staying in touch with the clients and our partners to get an understanding of what they're doing," Scribner says.

Huntsman and Scribner are not alone in advising their compatriots to spend the next few months focusing on both weathering the storm and preparing for what may be on the other side.

"We've had a few projects put on hold," says Mike Brown of Newmark Knight Frank, one of the world's largest real estate services firms, which has been operating a San Francisco office since 2002. "I expect those to resurface sometime in 2009. In the meantime, we will be focusing on being flexible in terms of termination options, expansion options and contraction options while also preparing for when the market settles."

At Skyline Construction in San Francisco, president Arne Ericson, who started with the company in April 2008 and has 18 years of industry experience, says past experience has taught him that the bust half of a cycle can be a good time to start a business.

"You're starting at the bottom and running a lean and mean operation," Ericson says. "Every recession I remember, they always end. Recognizing that things come back, you want to be in a robust position."

Ericson recommends using the downtime to enhance business—from a talent perspective, a niche perspective and a general practices perspective.

"I think right now, we're starting to see in our local area contractors feeling the effect, because we lag behind other places, and some are letting people go that eventually they'll want back," Ericson says.

"There's work in retrenching," he says. "When you're a contractor and lean and mean and hungry, you have to be creative about looking for opportunity."

The companies that make it through the current recession may not be seeing the sort of profits they had become accustomed to seeing.

"San Francisco has this incredible teflon texture," says Tim Tosta, a land use attorney for Luce Forward whose been working in the Bay Area for the last 34 years, "but I think the city's remarkable resiliency could jeopardize the market's future. Because the market has never gone down as deep or stayed down as long as in most other cities, I think city government developers and agents should be rethinking their unreal expectations. On the other side of this recession, I suspect the profit margins won't be as large."

He says that while businesses with excellent in-house funding could find themselves picking up bargains, capital will most likely continue to be difficult to find, forcing many developers to be more conservative in their decision making.

"If you can't put away your need to line your pockets—developers and cities alike—you're not going to survive," says Tosta.

Tosta, and other long-time professionals, stressed the importance of working together in this new market. They also say that patience and flexibility will be key virtues in this market.

"We will all have to learn about this new world together. Those who decide to learn that separately will learn it hard." ■

Andrew Burmon assisted in writing this article.

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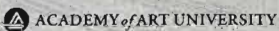

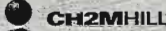
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



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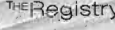
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