DEVELOPING THROUGH A DOWNDRAFT

BY RICHARD E. JORDAN II, CEO/COB, SMITH LAND & IMPROVEMENT CORPORATION

2008's economic Big Bang has given the real estate market an acute case of vertigo. For landowners and developers, we now have to discover and reach a responsible equilibrium.

It's difficult to target one episode that ignited the loss of credit and confidence, but its international distress continues to be felt by the financial, real estate, construction, and manufacturing industries. A combination of self-serving and harmful decisions, regulatory omissions, and gross assumptions spawned a toxic evolution that, in hindsight, became alarmingly obvious to businesses and citizens alike.

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What demands our full attention now is the path to real estate development recovery and a return to prudent investments and enduring economic expansion. As we forge ahead, experience and equity will provide the best medicine for communities desperate for relief. Is this the worst cycle we've ever experienced in central Pennsylvania? No. Is this terminal? No. Is there reason for uplook? Yes.

The banking industry has experienced wild swings—initially lending when it defied common sense, and now restraining capital when it defies common sense. For some developers, "the decline in property values and tighter credit has forced them to sell assets in a rush and also pressured them to raise cash to balance out the disparity between the falling values and the loans used to purchase the properties," (Matt Turner, *The Wall Street Journal*, 2.12.09).

As a third-generation real estate development firm, Smith Land & Improvement Corporation has pursued projects driven by a conservative philosophy with a fixation on building equity. Central Pennsylvania is fortunate to have a handful of experienced, well-capitalized developers who did not over-leverage at the risk of losing investments or forfeiting the economic advantages these developments bring to our region.

The difficulties of the past 15 months present challenges on many fronts—we must keep the business afloat, look for opportunities, shore up the bottom line, reduce overhead, sustain morale, and conserve cash—straight through the downdraft. Imagine surgery in the operating room without the lights.

"Taking all the bad news in stride, most real estate players should uncomfortably ride out the storm. 'As long as you can sit with what you have, you'll be fine,'" states the Urban Land Institute's Emerging Trends in Real Estate 2009.

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How does one uncomfortably ride out the storm?

1. **Equity is king.** Developers with cash and no near-term debt maturities will be winners. Prior recessions have taught us that a "war chest of cash" is critical to agility and survival; therefore, our development plan for sustainability in a downdraft is simple—we pause. Forty of our Pennsylvania properties are in varying degrees of maturity and development. We have not sidelined any projects in our pipeline, but we are using this cycle to acquire entitlements and develop stronger real estate networks.

2. **Diversity ensures a profitable risk tolerance.** For industrial, office, and retail complexes, we have learned to expand our tenant base to include local and national players. Well-recognized anchors and credit tenants remain the foundation of real estate portfolios, but a community's cultural fabric and small business success are strengthened by prime placements of local diners, banks, and retail boutiques. Negotiating strong leases with diverse clients provides economic stamina during hard times.

3. **Choose not to absorb the background noise and steady drumbeat** that this is the next Great Depression. As a real estate executive, I have experienced five recessions, including this one that began in December 2007, and I understand the power and long-term effects of economic pessimism. The crisis of the early 80s that skyrocketed interest rates to 21% and the dot com exuberance of 2001 caused significant financial and psychological pain—a pain that wields life lessons not learned in any college business classroom. However, rarely do we see double digit increases or decreases in central Pennsylvania. We have foothills, not mountains of economic cycles. Adam Kohler of Fameco Real Estate in Philadelphia agrees: "This region is in better shape than other regions where there was 'tremendous over-building,' like Arizona, Florida, and Las Vegas" (*Patriot-News*, 2.20.09).

4. **Stay in familiar geography.** We do not outsource our eyes. Our focus is on doing business in our own front yard, believing that local development equals local prosperity. We live, work, and shop where we own and manage properties. Both large and small tenants value the face-to-face accessibility and responsiveness of the owner. When you live where you develop, you have a clearer understanding of real market values, and there's minimal chance for financial hyperbole.

5. **Increase your *Commitment to Community*.** At every level, the community must be engaged for any retail or commercial venture to flourish. Developers need community support and communities need convenient, affordable, and attractive retail stores and offices. As developers explore immediate cost-cutting measures, pulling back from community commitments is rarely positive in the long term. Whether it's supporting a non-profit, a hospital capital campaign, or an Eagle Scout Recognition Dinner, we remain dedicated to our base.

Although this systemic collapse has paralyzed some of the country's biggest lenders, borrowers, and developers, companies with a conservative business model will survive. And when liquidity returns, well-capitalized developments will help shape the new economic equilibrium.

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