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Distressed Property – Diamond in the Rough or Lump of Coal?

Nobody is disputing that today's real estate market is tough. Property values across the nation have dropped anywhere from 11 to 40 percent, but there are opportunities as well. "Hard assets" such as real estate can still be a viable investment. Whether buying or selling a distressed property, it is important to be knowledgeable about its real value.

There are three main factors that contribute to a property's value:

- **Location:** The mantra "location, location, location" has been ingrained into our psyche. Although it is a critical factor, there are other powerful forces that interact with location to determine property value.
- **Potential:** Every property has unique opportunities and challenges that affect its potential. Physical constraints and local government regulations can be liabilities or assets. The presence or absence of wetlands or utilities, for example, can play a huge role in the property's potential for future development or redevelopment.
- **Timing:** Real estate always has value, but it does need to reinvent itself to keep up with current demographic pressures and demand. A few decades ago, for instance, strip malls popped up wherever a new intersection lent itself to commercial development; now, those strip malls are being rebuilt or replaced by alternatives to accommodate the evolution of consumer preferences. Timing is the ability to recognize where a property is in its cycle.

There is no shortage of reports, studies, and other documentation that can be used to investigate a property's location, potential, and timing (Fig. 1.0). This plethora of information can be problematic, however. Ordering every research and due diligence report available for a given property could end up costing tens or hundreds of thousands of dollars, only to reveal that a property isn't viable. For property owners or speculators in the real estate market, the following guidelines will maximize value and minimize liability.

Initial research and analysis: Many property owners and speculators know enough about real estate and land development to conduct a preliminary assessment. Due diligence will be most efficient when consultants are hired to take care of the more advanced steps.



Fig. 1.0 Real Estate Due Diligence Reports and Services

Market Study (Location, Timing)

Adjacent Land Use
Competitor Proximity
School District
Real Estate Activity Review
Demographic Study

Government Regulatory Review (Potential)

Building Code Records Review
Zoning Code Records Review
Zoning Ordinance Report
Comprehensive Plan Review
Federal, State, and County Agency
Regulations & Oversight

Physical Characteristics (Potential)

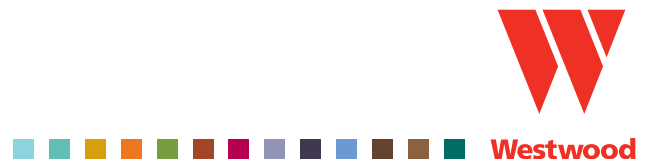
ALTA Survey
Utilities Accessibility Study
Phase I Environmental Report
Wetland Delineation
Floodplain Evaluation
Topographic Data & Review
Geotechnical Report
EAW, EIS, & AUAR
Access & Traffic Study
Historic/Archaeological Review

Less is more: The focus should be on what is minimally required to meet the owner or speculator's investment objectives or their need to reduce risk. In this economy, there are ample opportunities to acquire incredibly under-valued properties. It may be more prudent to do just enough research on several properties, in order to select the one with the best balance between value and risk, than it would be to do a full-fledged study on a single property.

Strategic implementation of research: Due diligence and research are most effective when tailored to a property's unique features and to the owner or speculator's specific goals. If the property will be a long-term investment, for example, regulatory analyses or market study reports are not a high priority because those factors will change over time. By contrast, the property's physical constraints are worth analyzing, because they have long-term relevance.

Whether you've got distressed properties in your possession or are looking to acquire them, it's more important than ever to be smart about real estate transactions. With the right approach, you can tell a diamond in the rough from a lump of coal and make your decisions accordingly.

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