

Distressed Assets

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What is a “distressed” asset?



- **Distressed commercial properties are real estate assets that are under financial strain or in poor physical condition.**

Financial Distress

The owner may be unable to meet mortgage payments, leading to potential foreclosure or short sales.

Physical Condition

A property can also be distressed due to poor physical condition, such as deferred maintenance, outdated features, or environmental issues.

Underperformance

High vacancy rates, low occupancy, or poor management can also classify a property as distressed

● **Properties that are in financial distress and can't keep up with**
● **outstanding debt might face the following scenarios:**
●

Short Sales

**Properties sold for less than
the owed mortgage
amount, with lender
approval**

Foreclosure

**Properties sold at public
auctions after the owner
defaults on the mortgage**

**Real Estate Owned
(REO)**

**Properties owned by
lenders after
unsuccessful short sales
or foreclosure auctions**

THE STATS

- The total amount of distressed commercial real estate assets in the US hit **\$107B** by the end of Q4, a decade-high and a 24.3% YoY increase
- **Office accounts for nearly half of the total distressed assets (\$51.6B)**
- Distressed property sales, while still a small portion of overall deal volume (2.5%), saw the largest share since 2015, suggesting a potential shift.

...Not necessarily any of this



How did we get here?

The market saw a significant increase in distressed properties due to the ongoing impact of the COVID-19 pandemic and the shift to remote work. Many office buildings faced high vacancy rates and declining property values

2022

There were signs of stabilization, with the rate of increase in vacancy rates decelerating. However, the overall vacancy rates were still higher compared to pre-pandemic levels

2024

2023

The situation worsened as more landlords defaulted on their loans, and the delinquency rate for office loans began to rise

**Decreased value
High interest rates
Low Demand**

Challenges

Managing distressed assets comes with its own set of challenges, the most prevalent being uncertainty

Cash Flow

Funding can be especially slow causing increases in aging AP, opex management, and added protocols to invoice processing.

Staffing

With the property's future in limbo, staff morale can easily decline and contribute to an increase in turnover

Demands

The number of stakeholders can increase, resulting in having to answer to many different governing bodies while receiving little to no direction in return

Competition

The increase in vacancy and sublease market means the competition for lease deals are extremely high

⋮ Come
back
to the
office!



: Failure to Adapt



MEETING THE CHALLENGE

UNDERSTANDING THE AUDIENCE

- Keep in mind the incoming owner or controlling entity (lender, receivership, etc) may have limited experience in Bay Area real estate, even less so in the details of property management
 - Pivot your communication style to educate
 - Don't assume knowledge of local codes, taxes, etc. are understood by the decision makers
- As building ownership transitions continue to progress, understand you will be repeating yourself and repeating yourself again
 - Create easy to reference deliverables

MEETING THE CHALLENGE



ADJUST THE STRATEGY

- Support the priorities of the current situation:
 - Cost saving solutions
 - Automate as much as possible
 - Create, recommend and implement a consistent funding protocol
 - Support leasing efforts
 - Focus spending on life safety and mandatory compliance items
- Communicate and be patient with your team and the building staff
 - Be transparent
 - Accountability is critical
 - Align on messaging to the tenants

MEETING THE CHALLENGE



ADJUST THE STRATEGY

- Don't undervalue tenant relations
- Leverage Technology:
 - Technology is playing a pivotal role in the recovery and evolution of CRE. From virtual tours to smart building systems, embracing innovation is essential for attracting tenants and investors. The integration of technology in property management is enhancing efficiency and tenant satisfaction

HOW YOUR VENDOR CAN ASSIST: JANITORIAL SERVICES

Open Communication for Effective Collaboration

- Clearly communicate financial constraints and property goals.
- Enable the vendor to tailor solutions to meet your specific needs.
- Proactively address union requirements and maintain open dialogue with union representatives.

Enhancing Tenant Satisfaction

- Maintain consistent service levels to ensure tenant satisfaction.

Enhanced Property Maintenance

- Keep key areas like exteriors, lobbies, elevators, restrooms, and vacant spaces clean and presentable.
- Utilize specialized cleaning services (carpet extraction, window washing, pressure washing) to enhance property appearance.

Effective Cost Management

- Adjust the scope of work to minimize impact while maintaining standards.
 - Reallocate tasks to Day Porters to optimize resource utilization and potentially realize cost savings.
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HOW YOUR VENDOR CAN ASSIST : BUILDING MAINTENANCE

#1 You must still maintain equipment

But you can save money via reducing energy consumption and overtime.

Energy

- Go floor by floor and see what you can turn off, AHUs, lighting, turn off dampers, minimal run time, make sure that everything still works in fire mode. Take services offline.
- Spending to Save: Sensors -title 24 occupancy sensors, spend money to save money, Gridium – determine peak energy and avoid the extra tariffs, PGE Audit

Overtime – get pre approval, formerly OT would have been required to take care of work when work that was required on the weekends, work can sometimes now be done during straight time due to less occupancy/higher vacancy.

Other creative ideas (these are not endorsements and have risk)

- Staggered PMS- from quarterly to semi annual
- Deferred Maintenance, reduced capital spending
- Reduced staff? Vendor heavy PMs will cost more.
- Empty site? Good time to do projects, retro commissioning, audits, TAB

Communicating with Your Engineering Staff

- Vendor payments
 - Unachievable standards
 - Manage Expectations
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Why are distressed assets attractive to some investors?

Potential for Upside

Investors may see an opportunity to acquire a property at a discounted price and then improve its performance through renovations, repositioning, or better management.

Bargain Opportunities

Distressed assets can be seen as bargains, especially when sellers are facing financial pressure and need to sell quickly.

Creative Financing

Lenders may be willing to offer creative financing terms to distressed assets, which can increase the chances of a strong return

Embrace our resiliency!

This is not the first or last market fluctuation our industry will experience:

- **Lean into your network and BOMA OEB**
 - **Leverage technology to enhance your operations**
 - **Lessons learned during this tumultuous period will shape a more resilient and sustainable future for commercial real estate**
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Q & A

