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# The Other Side of Natural Disasters

Expect lenders' concerns over collateral damage and loss of income stream

**WHEN SUPERSTORM SANDY DEVAS-**tated metropolitan New York and New Jersey this past year, it served as an unpleasant reminder to lenders of how natural disasters may unexpectedly damage the properties securing their commercial loans. This type of damage hits office buildings, shopping centers, warehouses and multifamily-apartment buildings regardless of property class, ownership structure, or state and national borders.

Many areas, of course, are more prone to particular types of natural disasters than others. Think earthquakes in Japan or California, hurricanes in Florida and Louisiana, or floods and snow storms that frequently incapacitate the nation's capital and the overall Northeast United States.

With these risks in mind, it's vital for commercial mortgage brokers to understand how lenders identify and assess the collateral damage, and to focus on financing opportunities that may be created by these disasters. Here are four points to consider:

**1. A new structure of supply and demand:** Natural disasters realign the allocation of supply and demand for commercial rental properties because they halt national and international businesses' operations for weeks because of power outages and structural damage that may prevent access to buildings. Natural disasters also may lead to the spoiling of inventory supplies, and in the case of sudden disasters, even cause injuries and casualties inside certain buildings. The experience of recent disasters fuels

tenant demand for rentable commercial space equipped with the latest, most durable structures and systems with sufficient drainage to mitigate flooding. For example, tenants who can't afford downtime or have expensive equipment, inventory or documentation often look for commercial rental space in buildings that have functioning electricity generators and backup generators located on high floors to avoid flooding. These tenants also may look for reinforced windows and walls to withstand winds, new roofs to withstand the weight of heavy snow, strong foundations to mitigate earthquakes, and on-site emergency staff and plans.

**2. Functional obsolescence:** Expect lenders to be cautious in lending and to target properties that won't become functionally obsolescent for failing to upgrade and meet this tenant demand. An obsolescent property will not be able to demand high rents and will lose tenants — i.e., lose the income streams necessary to repay debt service.

**3. Recognize opportunities:** In the aftermath of any natural disaster, it is likely for commercial mortgage brokers to see an increased demand on construction loans for redevelopment. The stronger tenant demand for safer and more secure buildings typically encourages landlords to redevelop and upgrade their buildings and systems to avoid obsolescence, remain competitive, and retain and attract tenants.

**4. Stronger buildings create stronger income streams:** With the memories of recent disasters and the expensive and lasting damages they cause, tenants likely are more willing to pay a premium for buildings that can withstand natural disasters. Lenders view this rent premium favorably because it increases an asset's potential for higher income that can cover the debt service.

Commercial mortgage brokers who understand the preceding points will be in a good position to understand lenders' concerns over the damages natural disasters cause and how these concerns can impact a lending decision. They will recognize the business opportunity that these damages create as property owners seek financing to redevelop properties and to make them more secure. ●

*Disclaimer: The above is for informational purposes only and does not constitute legal advice.*

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