Northwestern Kellogg
School of Management

KE1106
May 15, 2019

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A Tale of Two Properties:
Debt Strategies for Financing Commercial Real Estate

With interest rates near an all-time low in late 2015, Stanley Cirano decided to review the financing on his holdings of commercial real estate. Cirano Properties was the owner of two separate retail shopping centers in suburban Chicago.

The first was Brookline Road Shopping Center, which Cirano had acquired in 2006 and had managed through the financial crisis and real estate downturn. The property was performing well, and Cirano wondered whether he should refinance or sell it. The second property was Columbus Festival Plaza, which Cirano had acquired in a bankruptcy auction in 2010; although the property had required a large amount of capital improvement, Cirano was proud of the growth of net operating income (NOI) he had generated.

The two properties had many similarities, including that they were both significantly financed with debt. At the time he purchased the properties, Cirano simply borrowed as much as he could from the lender with the lowest interest rate he could find. Since that time, Cirano had learned that there was more to the optimal financing of commercial property than just dollars and rates. Nonetheless, Cirano was convinced that interest rates would soon rise, and so he thought it made sense to consider the debt options available to him, and make a sound, strategic decision on the financing of both of his assets at the same time.

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Stanley Cirano

Born and raised on the north side of Chicago, Stanley Cirano had been attracted—as many people were—by the weather and opportunities in California's technology sector in the mid-1990s. A bit of good timing landed Cirano a job at an internet startup about 18 months before it went public. Shortly before the dot-com crash, Cirano sold his shares for over $8 million.

Cirano's windfall attracted the attention of private wealth managers, who convinced him to invest in commercial real estate. To try it out, in 2001 Cirano invested $500,000 in a triple-net lease property occupied by a branch of the U.S. Postal Service. The investment was a perfect introduction to commercial real estate—it required a relatively small equity investment and carried little risk because the government's lease ran through 2011. When Cirano sold the property in 2005, he acquired a little more wealth but, more importantly, much more confidence in his ability to make a career in commercial real estate. Thus, Cirano Properties was born.

Brookline Road Shopping Center

After his initial success in real estate, Cirano sought to increase his investments in the sector. He invested $3.5 million of equity toward the $10 million acquisition of Brookline Road Shopping Center. The 65,611-square-foot shopping center was located in Buffalo Lakes, a suburb northwest of Chicago, with a median household income of $128,876. The property sat at the high-visibility corner of Brookline and Mundee roads.

Brookline Road Shopping Center was built in 2004, and Cirano acquired the property from the developer two years later. Cirano liked the new construction and excellent location, and the property enabled him to rent the space that the developer had not yet preleased. Cirano successfully grew Brookline's NOI from $754,000 in 2006 to nearly $900,000 in 2015 (see **Exhibit 1**). Cirano believed that he had navigated the financial crisis well, and the 2010 leasing of the final vacant space to Chipotle was a major factor in the property's income growth (see **Exhibit 2**).

For the past few months, Cirano had wondered whether now was the time to sell. Cirano knew some real estate investors were cashing out, but others wanted to wait until they found an attractive opportunity in which to invest any sales proceeds. Alternatively, perhaps a refinancing would allow him to recoup much of his initial investment while continuing to receive the steady and growing cash flows from the property.

The original $6.5 million loan on the property had been originated by Skyline Bank. The loan had three months remaining on its original 10-year maturity. It had been amortizing on a 30-year schedule and carried an interest rate of 6.70%. The loan's five-year lockout provision[1] had expired in 2011, and a prepayment penalty of 3% of total prepaid balances was waived within the final six months before maturity.

[1] A lockout provision is a clause in a mortgage contract that prevents the borrower from prepaying the loan during a specified time period.

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