

Q&A

Petroleum Capital's Donell: Gas Station Property Defaults to Increase as Much as 20 Percent



Defaults on loans made to gas station owners could climb as much as 20 percent in the next two to three years, says **Stephen J. Donell**, co-founder of Los Angeles Advisory firm **Petroleum Capital Advisors**. In an interview with Aleksandrs

Rozens he says the defaults are tied to a decline in consumer spending amid higher gas prices and tighter credit conditions.

Q: Gas prices are up. So, why are gas station owners running into trouble?

A: There are two types of defaults. One is a default where it's a cash flow issue and the owner does not make, for example, a February 2012 payment. Another is a maturity default. Back in 2006, 2007 and 2008 the lending criteria was much looser than it is now. Often, the gas station owners got an SBA loan that had a five- to seven-year maturity and it was easy to get the loan. The underwriting guidelines were very loose. Those loans are now maturing and they don't have ability to pay off the mortgage.

Q: So it's a refinance issue that's coming up?

A: That's one of the issues.

Q: Is that refinance issue coming up because the SBA lenders have pulled back or is it that all lenders, generally, have pulled back?

A: It is really because all lenders have pulled back. There are a lot of different issues that come into play with respect to getting new loans. For example, in some cases the lenders are requiring Phase II environmental reports before they will offer a loan. The overall terms of the loans are much more stringent, making it much more difficult to get a new loan. Indemnification agreements are much more stringent today than they were five to seven years ago. Although interest rates are lower you are going to get lower loan to values and the terms are much much tighter than they were before. The other type of default we have is one that is pure cash flow. To answer your question

'Gas prices are up so how can gas station owners be failing?' Generally speaking the margins on gas are very slim. As prices rise, the margins stay the same. So the higher gas prices do not correspond to higher profit for the gas station operator. It may correspond to an increase in profit for the gas station provider, Shell Oil for example. The real profit margin on gas station properties includes the sale of goods at convenience stores as well as mechanics working at the gas stations and car washes. People have less disposable income. They are spending less, getting their cars washed less. They are spending less on getting cars repaired. And, they are spending less buying gum, Coke, and those spontaneous purchases in the convenience stores.

Q: Broadly, we are all traveling less.

A: People are actually buying less gas. They are being more conscientious which means they have less occasion to stop at the gas station in the first place. Not only do people have less disposable income to spend money on those high profit items, they are actually visiting the gas stations less as gas prices increase. It's two areas: maturity defaults because the owners cannot refinance their way out of their existing loan. And, it is cash flow defaults. What lenders very often do is they will have a receiver appointed. A lender does not want to foreclose on a gas station because the process of foreclosing means the lender becomes the owner and they can be subject to environmental claims or any other type of remediation issues or other types of liability an owner would have. Lenders are loathe to cross that line in certain circumstances. What they do is have a receiver sell the property through a court-ordered process.

Q: Have lenders tried to duck the issue and extend the loan for a gas station?

A: It depends on whether this is a loan that is a CMBS loan being serviced by a master servicer and what the REMIC guidelines are or if it is a direct lender. It's not blanket that no lenders ever do the extend and pretend route. Sometimes the lenders are involved in active negotiations

with their borrowers to try to achieve some sort of resolution that would involve either a restructuring of a loan or an extension of a loan.

Q: When that happens, does the lender incur a loss? And, how much of a loss is incurred?

A: The lenders are taking losses. In the last four or five sales that I have personally been involved with as receiver, the losses have been anywhere from a high of almost 50 percent to a sale where the lender took only a 15 percent loss. The lender will agree to take less than the principle loan amount or the principle loan balance. So, in that way it is somewhat similar to a short sale although you don't ever hear the term short sale for a commercial property.

Q: What's your outlook on the gas station industry?

A: I would expect that for the next 24 to 36 months we are going to continue to see an increase in defaults of gas stations, probably in the 10 to 20 percent range for a couple of reasons. Number one, we have got a relatively jobless recovery and income levels are not right. We've got a lot of volatility in the financial market and the lenders are still tightening their belts with respect to underwriting criteria. I don't see that the qualification process for loans is going to get any easier any time soon. We obviously have a lot of national and international issues going on with gas that are going to have upward pressure on gas prices. All of those trickle down together on a cumulative basis to not make it a really pretty picture for gas station operators on the edge.

Q: How many gas stations are there in the U.S. market? When you say 10 to 20 percent, is that a percent of that total that are in hot water?

A: I'd say that we'll see a 10 percent or 20 percent increase in the number of stations that are in default. I don't have a specific statistic on the gross number of stations across the country.