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Quarterly Investment Report: Second-Quarter 2009 - Small Q2 Gains Hint at Increased Activity to Come

By JENNIFER CATERINO

CREJ Managing Editor
For real estate market watchers, the first quarter of 2009 was a tough act to follow.
Though the state's transactional volume of deals $5 million or greater had been on a steady decline since third-quarter 2007, according to **Real Capital Analytics**, a new low was set in the first quarter of this year when $1.3 billion in deals was recorded across all sectors.
Fast forward to second-quarter 2009. With just $1.9 billion in sales, there is little cause for celebration. But the figure exceeded that of the prior quarter, and many brokers say it belies the activity they are starting to see in the marketplace.
"Activity has been picking up. There are a lot more users that have come out to the market willing to ink lease deals and take advantage of the decrease in sale prices," said Mark Zorn, executive vice president, **DAUM Commercial Real Estate Services** in Ontario, who specializes in industrial product, which posted a statewide total of $366 million compared with $294 million in the previous quarter.
According to Real Capital Analytics, at $690 million in total transactional volume, the office sector led statewide, though multifamily trailed closely with $618 million. When compared with the previous quarter, the office, multifamily and industrial sectors posted gains of $215 million, $287 million and $73 million, respectively.
Retail transaction volume, mirroring the sector's woes, dropped $119 million from the previous quarter to $198 million.
Fouy Ly, senior vice president, **Sperry Van Ness** in Irvine, said he anticipates retail will experience further deterioration before rebounding.
"Through the rest of the year, we're going to see higher vacancies," Ly said. "We're going to see a higher amount of bank-owned [properties] and a higher amount of stress for the retail ownerships out there. We're anticipating it getting worse before it gets better."
Ly said capitalization rates for retail sales have been all over the board.
"For single-tenants, it's in the 7 percent [range]. For multi-tenants that are small, it's still relatively low in the 8-plus cap rate," he said.
Across the sectors, brokers reported capitalization rates in the mid-6 to 7 percent range, reaching 8 percent in tertiary markets. According to **LoopNet Inc.**, the statewide 12-month rolling average capitalization rates inched up slightly across all sectors to 6.1 percent for retail, 6.5 percent for office, 6.9 percent for industrial and 5.7 percent for multifamily.
The active buyers, brokers said, are largely high-net-worth individuals looking for the bottom.
"This market allows them to compete with institutions because institutions are at a standstill," said Bob Safai, founding partner of **Madison Partners** in Los Angeles. "We are looking at values deteriorated from 20 to 50 percent in some markets. High-net-worth individuals get the full value [because] when you buy an asset you get a depreciation schedule."
Safai said the balance of the buyers mainly is comprised of opportunity funds, while pension funds remain on the sidelines trying to determine allocations.
Though brokers say both sides are inching closer to the middle, in light of diminished values and rising distressed sales, vestiges of the buy-sell gap remain.
Kitty Wallace, senior vice president in the Los Angeles office of Sperry Van Ness, quipped some brokers aren't looking for distress - they are looking for road kill.
"There is a group buyers not getting deals done because they have unrealistic expectations," Wallace said.
According to Wallace, the seller group has expanded, but that doesn't mean others aren't trying to wait out the market by holding or refinancing. Sellers, too, range from those whose pricing is unrealistic in this market to others willing to get deals done.
California boasted a second-quarter offering volume of $12.7 billion - nearly seven times what closed - according to Real Capital Analytics, but Rick Reeder of **Grubb & Ellis|BRE Commercial**

in Carlsbad said there are few office and industrial properties on the market in San Diego County and there has been very little activity, so far, involving troubled assets.
"There is still talk that there will be a tremendous amount of property that comes to the market through foreclosure, the [Federal Deposit Insurance Corp.] or for various debt-related reasons," Reeder said. "But the sellers out there so far are sellers that needed to sell some properties due to fund redemptions or loans coming due."
Some distressed deals are getting done, however, and most expect that trend to continue into the next quarter and the remainder of the year.
For example, following second-quarter negotiations, **Argonaut Private Equity Group** closed on the $40.8 million note for the distressed 250 Montgomery St. in San Francisco for roughly 50 cents on the dollar - amounting to that region's first major Class A office transaction of the year.
Randy Getz, executive vice president and investment specialist with **CB Richard Ellis** in Sacramento, said it's still unclear how much distressed real estate will be hitting the market.
"It's still an evolving process. We really don't know how the lenders are going to deal with it," he said.
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Quarterly Investment Report: Second-Quarter 2009 - O.C. Buyers Start to Pull The Trigger

By JULIE NAKASHIMA

CREJ Staff Writer
Orange County's commercial real estate investment market entered 2009 with a united front - all four of the main commercial property types were united in posting dismal numbers for the first quarter. But then a big bifurcation emerged as apartments, office and retail posted significant gains while industrial took a sharp fork downward.
According to **Real Capital Analytics**, the volume of industrial transactions of $5 million and above declined 36 percent to $97.9 million in the second quarter, compared with $153.1 million a year ago.
According to Louis Tomaselli, an executive vice president with **Voit Real Estate Services**' Commercial Brokerage Division, the volume was only one-twelfth the typical volume for Orange County industrial investment sales.
"It's been a very slow summer," he said.
He said just two large institutional transactions took place during the second quarter, both involving the same seller - **Prudential**. The financial services giant, which has been trimming its real estate holdings across the country, sold a 260,000-square-foot distribution center to **KTR Capital Partners** on May 15 and a 32-acre, 11-building multi-tenant business park in Laguna Hills to **Watermarke Properties** on June 30.
Tomaselli said the price for the Santa Ana property was $25.5 million and the capitalization rate was 9.5 percent on in-place income. However, the rent was about 15 percent over market, he said, so the capitalization rate actually was 9 percent based on today's adjusted market rents.

The 94 percent occupied Laguna Hills business park, known as Saddleback Business Park, sold for $62 million and a reported 8 percent capitalization rate.

Tomaselli said nothing else of any size has come to the market.

"The majority of the Orange County owners of industrial real estate still have not become sellers at this price level," he said. "In the few cases where there may be some distress from having a loan come due, the owners that I've spoken with are already working out those arrangements with their lenders in advance."

On the office side, the transactional volume increased 46 percent to $321.7 million in the second quarter from $220.4 million a year ago. The quarter included two notable deals: **Maguire Properties**' sale of 3161 Michelson in Irvine to an affiliate of the New York-based **EMMES Group of Cos.** for $153.4 million, and **Transpacific Development Co.**'s purchase of One and Three Premier Place in Irvine from Ford Motor Co. for $73 million.

According to Steven G. Economos of the Irvine-based Economos Group at **NAI Capital**, the two next-largest sales were for $60 million and $30 million, but after that the deal size in the second quarter drops to $5.9 million. He said the majority of the office sales in Orange County have been owner-user transactions.

Citing figures from **CoStar**, he said 27 office sales closed in the second quarter versus 36 sales in the first quarter. At the same time, Economos pointed out that, at $22 million, the largest deal in the first quarter is smaller than any of the four largest transactions in the second quarter.

The discrepancy between buyer and seller expectations was prevalent in the first quarter, he said, and although it remains a factor, he said sellers have gotten more realistic.

Economos said his group had more listings than ever in the first quarter but no sales, and now has two sales and four escrows.

"Not everybody needs financing," Economos said. "Those people who have cash are just waiting for good opportunities."

Meanwhile, capitalization rates for Orange County office assets have increased, but Economos said the continued lack of an investment market in Orange County means there aren't any bellwether comps everyone can look to as the new established pricing - take the 19-story 3161 Michelson building, which was 60 percent leased at the time of sale.

"I don't think anybody is necessarily applying a cap rate to that existing income," Economos said. "People are buying more on a per-foot basis versus a cap-rate basis."

For Orange County retail properties, Real Capital Analytics reported a 77.3 percent jump in volume to $82.3 million from $46.4 million. In contrast with a "very quiet" first quarter, activity in the second quarter noticeably began to pick up, according to Fouy Ly, a senior vice president with **Sperry Van Ness** in Irvine.

Most of the dealmaking was in smaller properties such as single-tenant net leased investments and strip centers closing in the 7.5 to 8 percent cap rate range.

"The biggest thing we need to see is consumer confidence," Ly said. "Housing played a huge part of it, but [low] consumer confidence for retailers is the kiss of death."

On a percentage-gain basis, apartments were the second quarter's biggest winner. Real Capital Analytics said the volume of transactions $5 million and above vaulted 132.4 percent to $257.9 million from $111 million a year ago. Four large transactions brokered by Ray Eldridge of **CB Richard Ellis** accounted for the lion's share of that activity: the 498-unit Avila in Rancho Santa Margarita, $70 million; the 386-unit Aventine and 484-unit Alize, both in Aliso Viejo, $56.3 million and $75 million, respectively, and the 349-unit Adagio in Santa Ana.

Steve Heri, a first vice president with CB Richard Ellis in Anaheim, said those four deals set the bar for the institutional market in Orange County.

"We've definitely seen an uptick in activity and more offers on our listings," Heri said.

He said capitalization rates for Orange County apartments have risen to an average of about 6.3 percent, based on 60 sales that have taken place to date. This compares with rates in the mid to high 5 percent range a year ago, and Heri sees capitalization rates trending toward 7 percent.

He took two properties in Newport Beach to market and got 10 offers at $225,000 to $230,000 per door at sub-5 percent capitalization rates.

"Sellers that really want to sell are becoming more in tune with the marketplace," Heri said. "There's plenty of capital out there, and they seem willing to pull the trigger today."
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Quarterly Investment Report: Second-Quarter 2009 - More Distress To Hit I.E.

More transactions closed in the second quarter, but large bid-ask spread remains

By KARI HAMANAKA

CREJ Staff Writer
Making the case for Inland Empire investment was the biggest challenge the region faced during the second quarter, especially in comparing the market with more favorably positioned properties in Los Angeles, Orange and San Diego counties. Even with brokers noting a slight increase in investment activity, transactions were off 80.3 percent in second-quarter 2009 from the year-ago period.
Total transactions across all property types ended the second quarter at $132.3 million, according to **Real Capital Analytics**.
"The first quarter was pretty quiet, and then in the second quarter there were a number of transactions and activity seemed to be picking up significantly than in the first quarter," said Mark Zorn, executive vice president in the Ontario office of **DAUM Commercial Real Estate Services**.
Although Zorn spoke specifically to Inland Empire industrial investment, the overall trend is expected to play out across all property types with more activity expected in the third and fourth quarters.
Though its image has been marred by an oversupply of speculative development and soaring vacancies, the Inland Empire office market recorded an increase in office investment totaling $27.7 million, according to Real Capital Analytics. Last quarter, the region did not see any office transactions over the $5 million mark.
Capitalization rates ranged from the mid- to high-7 percent, according to a **Marcus & Millichap Real Estate Investment Services** report for second-quarter 2009. Not surprisingly, core office submarkets such as Ontario, San Bernardino and Riverside are favored among buyers.
In general, the submarkets on the west side of the region tend to attract the most interest from investors. However, in the case of multifamily investment, the opposite seemed to be true during the second quarter.
"You're core area where you've got Rancho Cucamonga, Alta Loma - the nicer areas - there's not really a lot of looking," said Cray Carlson, senior vice president in **CB Richard Ellis**' Ontario office. "It's the tertiary, outer-lying markets from Barstow in, from Temecula in, from the High Desert - that's where we're seeing some activity."

According to Real Capital Analytics, no apartment sales closed over $5 million during the quarter.

Average second-quarter capitalization rates for multifamily were in the mid- to high-7 percent range, according to Marcus & Millichap.

Of the 25 deals that did close in the second quarter, Carlson said only a few were real estate-owned deals.

"It's [REOs] started to trickle in," Carlson said. "There's more this quarter than the last quarter."

However, like other property types, the market has yet to see the full extent of distressed properties on sale and much of that hinges on what banks' next move will be.

"I think there's more activity on them [REOs] now," Carlson said. "It's just that the banks haven't chosen to foreclose. They're still waiting to see where things are. People are noticing the defaults. The numbers are kind of ticking up, and the banks are going to have to start doing something."

As capitalization rates continue to rise, investor appetite for higher returns has made it difficult for sellers to sell as rents continue their descent. In the case of industrial, Zorn said rents have fallen 30 percent, leaving a large gap between buyers and sellers.

Industrial investment did increase from the first quarter, with sales totaling $81.48 million marked by small acquisition prices with high cap rates.

"There hasn't been much that closed this year just due to the fact that investor evaluations of pricing have changed," Zorn said. "They want an 8.5 to 9 percent cap on current market rents and not what the existing rents are in the leases. Because of the devaluation of properties, there aren't many building owners willing to discount property to those levels in order to give buying investors that type of return."

Of the more notable deals to close during the quarter was the sale of the three-building, 651,235-square-foot Jasmine Distribution Center to **KTR Capital Partners** from the **Adaya Family Trust**. The Fontana property sold for $29.4 million with an 8.4 percent capitalization rate based on market rents.

Other notable deals that closed during the quarter include Trader Joe's Co.'s acquisition of 574,080 square feet in Fontana from The Alter Group. **Prologis TLF LLC** also purchased 341,000 square feet in Ontario from **Meridian Realty Partners** for an undisclosed amount.

Despite the bid-ask price gap, Zorn said more and more sellers in need of cash are being forced to come down in price to meet investor demand.

"The bid-ask spread is way too big and it will remain that way until somebody flinches," said Fouy Ly, senior vice president in **Sperry Van Ness**' Irvine office. "It seems it will remain the same until somebody flinches. The buyer can't buy until they see a 9 percent cap because that's what they'll need to pull the loan."

Ly is advising his retail clients looking to sell in the next three years of the short window to sell, because cap rates are expected to increase another 100 to 150 basis points next year.

According to Real Capital Analytics, retail transactions in the second quarter totaled $23.1 million, a decline from the previous quarter. Capitalization rates for single-tenant properties closed out the quarter ranging between 6 and 7 percent, while multi-tenant properties averaged in the low- to mid-7 percent range, according to Marcus & Millichap.

"Here's the problem: The smaller deals like single-tenant under $2 million will sell," Ly said. "Single-tenant in the $4 [million], $5 [million], $6 million and above is harder to sell because the lending market is still not there."

In the case of multi-tenant, Ly said there has to be a compelling enough reason to buy with a relatively cheap price tag.

"From the lenders [perspective], the lender is just trying to dispose of it quickly and pricing property well below the market," Ly said. "There's really no compelling reason to buy in the Inland Empire right now."

Instead, investors across all property types are waiting for more vacancies, distressed

sales and lender-owned properties to come to market in the Inland Empire.
"They're waiting to see the Inland Empire get into a real bloodbath," Ly said.
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