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Time to Buy?

By: Mark Mueller

If you want to get a sense of why commercial real estate deal-making in Orange County has been slow of late, try getting yourself invited to an advisory board meeting for Newport Beach-based investment company Stoneridge Capital Partners.

Stoneridge is armed with close to \$400 million in cash, a veteran advisory board and management led by one of OC's most recognizable business names.

But even amid a downturn that's seen values for much of the region's commercial real estate properties plummet by a third or more in the past two years, Stoneridge has been in no rush to buy buildings, said Chief Executive Greg Merage.

"We have patient capital. Our only requirement is that things are fairly priced, meaning at a discount to replacement costs," said Merage, whose uncle is Hot Pockets creator Paul Merage.

The company could eventually buy upward of \$1 billion of assets, factoring in debt.

Paul Merage—whose name is on the business school at the University of California, Irvine—also serves as chairman of Stoneridge's advisory board.

The investment company's board of advisers counts several other big names.

Members include Dick Sim, formerly Irvine Company's chairman of investment properties; William Gaboury, who until a few years ago was chief executive of Walnut-based J.F. Shea Co.'s Shea Properties in Aliso Viejo; Edwin Fuller, president and managing director of international lodging for Marriott International Inc.; and Larry Webb, the former chief executive of homebuilder John Laing Homes who now heads up Irvine-based New Home Co.

Not at Bottom

According to Greg Merage, monthly advisory board meetings include plenty of differing viewpoints. But there's been agreement on one key fact.

"No one feels we're at a bottom yet," Merage said. "No one is pounding their fist, saying 'buy, buy, buy.'"

Stoneridge's beliefs echo the conventional wisdom surrounding much of OC's commercial real estate these days.

The optimistic view is that the market will bottom out midway through this year, with a recovery taking shape later in 2010.

A more sober assessment pushes back the timing of a turnaround into 2011.

"Like the national commercial real estate market, Orange County is not likely to begin to recover until early 2011," said Robert Bach, senior vice president and chief economist of Santa Ana-based Grubb & Ellis Co.

Grubb recently released its 2010 real estate forecast. The real estate brokerage and investor's view is that commercial real estate will continue to decline this year, albeit more slowly than in 2009.

Most property types should reach their bottom near the end of the year and begin a slow recovery starting in 2011, according to Bach's analysis.

"Because commercial real estate lags the labor market, it still has a ways to go before reaching its own low point," Bach said in a statement.

OC's unemployment rate now runs about 9.5%, up from 3.5% a few years ago.

"The good news is that the freefall we saw in 2009 is over and the future is more certain, giving owners and users of real estate the confidence to begin making decisions again," Bach said.

That freefall has had a big impact on both lease rates and sales prices of the area's commercial properties.

In OC's office market, monthly lease rates stand at about \$2.19 per square foot, pricing last seen near the end of 2005, according to data from Los Angeles-based CB Richard Ellis Group Inc.

For the industrial market, lease rates are off nearly 20% from their recent peak, while sales now are about \$140 per square foot, compared to about \$180 per square foot at the market's peak in 2007.

Industrial lease rates and sales prices are now at levels last seen in 2006.

Opportunities

Not everyone's endorsing a wait-it-out approach. Rather than wait until the market shows signs of stabilizing, tenants and prospective owners can still use the down market to their advantage, according to Greg Coxon, who heads up brokerage operations for Grubb's Newport Beach office.

"Buyers with cash will find numerous opportunities to acquire assets in default," Coxon said.

In addition, tenants that want to expand or renew their leases have many attractive options as landlords offer lower rental rates and unique concession packages to remain competitive, said Coxon, who also serves as president of the company's brokerage services.

Other area brokerages are beginning to see some positive signs in the market.

December was the busiest month of the year for the Anaheim Metro office of Voit Real Estate Services, according to Kurt Strasmann, managing director of the brokerage office there.

Deals that the office worked on last month included the largest industrial lease seen in OC in 2009, a 626,304-square-foot lease in Buena Park for Lakeland, Fla.-based logistics company Saddle Creek Corp.

Whether December's activity is the sign of a turnaround, or just deals getting completed by the end of the year, is uncertain.

There have been some encouraging signs seen in January as well, according to Strasmann.

While the number of sale and lease deals is down in OC, the county is actually seeing more activity than many other regions, local brokerages said.

OC has been one of the most active leasing markets in the U.S., driven by existing companies renewing their leases at favorable terms, according to a recent report from the Newport Beach office of NAI Capital Inc.

“We are beginning to see a migration from low rise to class A high-rise space as tenants take advantage of lower lease rates,” NAI researchers said in their 2010 market report, released this month. “Many existing companies are beginning to lock in long leases at rates that are at the lowest in 10 years.”

Among large office sales, OC also was a big source of deals in 2009, thanks to distressed asset sales of some notable buildings.

These distressed sales include the former Newport Beach headquarters of Downey Financial Corp., as well as the sales of several local buildings once owned by Los Angeles-based Maguire Properties Inc.

Through November, OC saw \$1.6 billion of larger commercial property sales in 2009, including \$789 million worth of office sales, \$361 million of apartment complexes, \$250 million of industrial buildings and \$185 million of retail properties, according to figures from New York-based Real Capital Analytics.

For Stoneridge Capital, which has been looking at properties in the \$20 million to \$75 million range—those too expensive for wealthier individual investors to buy, but too small to catch the eye of larger investment funds—the pickings have been slim in the past year, according to Greg Merage.

The last year primarily saw “lesser-quality deal flow,” Merage said.

Other than a \$70 million buy of a Rancho Santa Margarita apartment complex in the summer—and a recent shopping center deal near Palm Springs—the company’s opted not to buy too much of late.

“I think we’re still early on in the correction,” Merage said. “But later this year and 2011, could be great years for us.”