Value-Add Rejoins Investor Vocabulary

San Bernadino, CA—The term value-add is making a comeback these days in a growing number of deals. In a $30-million acquisition here, for example, a joint venture of Dallas-based Behringer Harvard and Aliso Viejo, CA-based CT Realty Investors bought four distribution buildings totaling 801,933 square feet that are only 29% occupied, but the new owners see a value-add play in the deal. Their bankers agree and, toward that end, private equity firm PCCP provided a $21.5-million senior loan.

According to Ron Bonneau, a partner with El Segundo, CA-based PCCP, "We are confident in the buyer's business plan to lease up the remaining vacant space to multiple tenants. Given the high quality of construction and the buyer's low purchase price, we believe the portfolio will become a competitive market participant, which previously was not the case given the distressed nature of the previous ownership."

In another value-add deal, Ezralow-Capital Valley Investments of Rocklin, CA acquired the 316-unit Whispering Oaks apartment complex in Walnut Creek, CA from Chicago's Equity Residential REIT for $48 million in a transaction that holds potential for rent growth through a renovation program. Mark Leary of the San Francisco office of Atlanta-based Apartment Realty Advisors, who, along with ARA's Curtis Gardner, represented the seller, says that "the property's location provides an opportunity for Capital Valley to increase rental rates through a renovation program. The highly sought-after class A location within the East Bay, coupled with a stable collections history and a strong value-add play, made this a logical acquisition."

Jeremy Mape of Western Realco LLC says that the Newport Beach, CA-based company is also seeking strategic, value-add industrial opportunities to take advantage of the strengthening real estate fundamentals in Southern California. Western Realco recently acquired the former headquarters of Knott's Berry Farm and plans to convert the approximately 200,000-square-foot facility into manufacturing and warehouse space before marketing it for sale or lease.—*Natalie Dolce*

Executive Moves

Los Angeles—Grubb & Ellis Co. hired **Thomas Swieca** and **Tony Archer** in the company's retail group as senior vice presidents. The duo joins from CB Richard Ellis, where they served as senior vice president and first vice president, respectively.

San Diego—Marcus & Millichap Real Estate Investment Services has promoted **Bill Rose** to western regional director of its national retail group. In addition to new duties, Rose will continue to serve as sales manager of the San Diego office. The firm also promoted **Marty Louie** from first vice president to CFO. ◆

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Industrial Update Brings Encouraging Signs

There has been a distinct uptick in the investment market for industrial real estate in Southern California, an encouraging sign pointing toward stabilization and recovery. For the most part, however, capital seems to be well ahead of market fundamentals. While 2010 was a year most of us are glad to see pass, it has nevertheless ended with an attractive window of distressed industrial investment opportunities that should remain in place for at least the next 12 to 18 months.

By Howard Schwimmer

The 2.1-billion-square-foot industrial market in Southern California fared better than the office and retail sectors over the past few years. Vacancy rates reached a plateau of 7%, average lease rates declined by 11% in 2010, new construction has been scant to non-existent, net absorption is finally positive in certain markets and capitalization rates declined significantly from highs of 11% to between 6.5% and 8.5%, on average.

These factors take into account the entire Southland, including the impact of big-box vacancies in outlying markets, whereas the infill, high-barrier areas in Los Angeles and Orange County have outperformed the overall market. Industrial vacancies in key infill markets range from 3% to 6%. Concurrent with the improving health of infill areas, distressed sellers are bringing assets out with increasing frequency. Foreclosures are up, lenders are starting to shed underperforming loans and sellers are weary from carrying overleveraged properties. Acquisition opportunities are on the rise.

While decreasing investment yields are most pronounced for institutional-quality assets, projected returns are more attractive for older industrial buildings. A flight to quality among institutional equity capital is prevalent, especially in fully leased assets that offer a current return. Impatient capital is placing upward pressure on the prices for these assets, producing yields that leave little margin for error as fundamentals recover. Conversely, investments that require a higher level of proactive management, leasing or capital upgrades define what is the biggest opportunity in the industrial market.

Creative solutions that transcend the capacity of some sellers are another component of successful investing. Profit comes to those experienced investors that are well capitalized, have the ability to perform due diligence quickly, counter risk with creative solutions and close with certainty. In an all-cash purchasing environment, generating superior returns is less a function of debt capital structures than of leveraging a sound strategy that creates value.

The opportunity exists to acquire older industrial assets in high-barrier Southern California markets at an attractive basis. The current investment climate requires active participation and a large pipeline of deals in order to identify those opportunities where return is commensurate with risk. By applying proactive, value-added strategies, these assets should deliver disproportionately higher returns than can be found in larger institutional properties.

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Vital Signs. . . Los Angeles ranks among the US' tightest industrial markets, with a 3.3% vacancy as of November.—*USC Lusk Center for Real Estate*