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Cassidy exec: Real estate bargains out there for investors

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LA JOLLA — Commercial real estate “fundamentals stink” right now for landlords, but there are plenty of bargains for investors willing to jump into the market, the **Cassidy Turley BRE Commercial** president and CEO said Tuesday.

John Frager was a guest speaker at a **Torrey Pines Bank**-sponsored event at the Hyatt Aventine La Jolla Tuesday.

Frager, who featured a slide of a pig with a mud-covered snout with the words “Fundamentals Stink,” reminded the crowd about just how ugly the commercial real estate markets have been during the past two years.

For example, the three-story, 45,670-square-foot Bonita Professional Plaza property at 180 Otay Lakes Road in Bonita sold for \$8.03 million in 2003.

The building fetched \$14.75 million in 2006, but just \$5 million in a transaction recorded earlier this spring — or nearly two thirds off its peak.

The story was a similar one for the upscale, 66,000-square-foot Hacienda del Mar property in the Del Mar Heights area.

That building had sold for \$27.5 million in 2007 and was transferred on the last day of 2009 for \$15.6 million, following a foreclosure.

Four Governor Park, a 46,640-square-foot two-building complex at 5080 and 5090 Shoreham Place in Governor

Park, has seen similar declines.

The property sold for \$7.2 million at the end of 1999, \$10 million in 2006 and is currently listed at just \$4.5 million.

Whole asset classes have continued to suffer. On the industrial side, some 4.21 million square feet of industrial space was returned to the market last year by Cassidy Turley BRE's accounts.

Otay Mesa is particularly overbuilt with plus or minus 3.5 million square feet of vacant space, depending on the survey.

The countywide retail vacancy, which had been less than 2 percent as late as 2006, ended 2009 at 5.9 percent, according to Cassidy Turley BRE.

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The 2009 activity translated to 1.2 million square feet of retail space being returned to the market.

Givebacks on the office side (about 476,000 in 2009) have reversed course thus far this year to 485,000 square feet, countywide, Frager said.

The countywide office vacancy, after peaking at 17.4 percent in 2009, now appears to be on a downward bias and finished the first quarter at 16.9 percent.

Frager suggested it will be a couple of years before there is substantive rent growth again.

He said average Class A office rent peaked at \$3.24 in 2007, but was down to \$2.71-per-square-foot as of the end of the first quarter of 2010.

"We should see a strong rebound in rental rates in 2012," Frager said.

The Class B rates are pretty much where they were in 2005, but those too have declined since then.

"And if you look at this on an inflation-related basis, there has been no rent growth since 1994," Frager said. "Fundamentals don't get much stinkier (sic) than that."

Frager said he expects to see more commercial defaults as

more and more property owners find themselves fiscally underwater.

Those who might buy these assets could have their own problems, because what may have been 70 or 80 percent loan to value ratios in 2007 are closer to 55 to 60 percent today.

This becomes an issue, if the owner wants to upgrade the property.

"Neither the owner nor the lender want to put in any more money in than they have to," Frager said.

As for construction, Frager said he doesn't expect to see any large commercial projects to come out of the ground until 2014.

The good news is it will give a lot of properties that were hammered during the recession a chance to lease up.

In the meantime, Frager said he doesn't expect a wave of foreclosed commercial real estate to flood the market. That doesn't mean there won't be problems, however.

"This is happening but it's going to be more like a train wreck in slow motion," Frager said citing the estimated \$1.4 trillion worth of commercial mortgage-backed securities set to mature between now and 2014.

Frager said commercial real estate fundamentals will be flat for the rest of the year, but was more optimistic when looking further out.

"Watch Del Mar Heights. That will be a bellweather of how the markets are doing," he said.

Frager added that poorly located and inferior commercial properties will suffer through 2010 and 2011.

There may be problems, but with more than \$200 billion of estimated commercial property investment capital currently on the sidelines, Frager said many investors are ready to jump at the right opportunities.

Frager said he could foresee the day when the commercial markets become superheated again and lenders become only too eager to lend once more.

"With all this capital coming, you can be sure that some dumb money will be coming along with it."

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