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Investors crowding into middle market L.A. office deals

More investors are looking at opportunities to buy mid-sized office buildings in Los Angeles, tapping into demand from creative tenants...

Samantha Rowan 11 May, 2018

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More investors are looking at opportunities to buy mid-sized office buildings in Los Angeles, tapping into demand from creative tenants for private and customizable space. And as part of this, long-time middle market players report that over the past 12 to 24 months, they're increasingly bumping into institutional buyers who have traditionally targeted larger deals.

"All of the larger assets in Los Angeles have traded hands over the past few years," said **Tim Lee,** v.p. of corporate development and legal affairs at **Olive Hill Group**, a Los Angeles-based investor, operator and developer of commercial real estate properties. "There aren't a lot of larger assets left, which means that core and core-plus investors are looking toward some of the mid-sized buildings that they might have ignored in the past. We're finding that there are two groups of tenants fighting over the same assets."

The phenomenon is being seen in buildings of roughly 50,000 to 100,000 square feet, assets that are generally sold for about $400 to $600 per square foot. Local players are finding that TAMI tenants, particularly tech companies, prefer low- to mid-rise buildings. "We find that these tenants value being able to get into and out of buildings quickly and that views aren't as important to them as other tenants," Lee said.

Harbor Associates, a Long Beach-based value-added investor, has been targeting middle market deals since its inception in early 2015. The firm, formed by a group of seasoned West Coast institutional players, has observed a supply-demand imbalance for middle market deals where an equity investor will be writing checks of $7m to $18m. "Traditionally, the larger groups that wouldn't write a $20m equity check are starting to push into that part of the market, if the boxes on the investment are lining up," said **Paul Miszkowicz**, principal.

As Harbor Associates has expanded its portfolio to more than one million square feet, the firm has rolled out what Miszkowicz termed a bespoke branded concept for value-added properties of roughly 30,000 to 50,000 square feet. The firm tends to acquire these assets while they're vacant and often works with a single tenant on a customized rehabilitation. "We're allowing tenants to customize that they want inside and we're also bringing these amenities to a building's exterior," he said. "More traditional landlords would create a building package but we work with the tenant to sign a long-term lease in a space that better suits what they're trying to accomplish."

Exterior amenities on Harbor Associates' properties can range from a dog park to an outdoor seating area and can go as far as incorporating a tenant's colors on the outside of a property for additional branding. "Tenants love coming out of a 10-story high-rise where they were a 40,000-square-foot tenant on two or three floors and going into their own space," Miszkowicz said.

Shlomi Ronen, managing principal and founder of **Dekel Capital**, noted the firm's focus on deals of $20m to $70 fits in well with the profile of the most common assets in Los Angeles. "There are very few deals in Los Angeles that are traded for more than $70m on an annual basis," he said. "If someone wants to get exposure to the West Coast, that investor will do so by buying smaller properties."

This activity is going on against a positive backdrop, with the Los Angeles office market expanding to submarkets like Santa Monica and Playa Vista, and the city making substantial infrastructure upgrades to the main airport, light rail, and subways, Ronen said.

"What's going on also speaks to where the excitement is on the West Coast," Ronen said, adding that tenants are paying rent premiums for properties that allow them to create a private, campus-type environment. Privacy is particularly important for tech, entertainment, and gaming-related companies.

Thorofare Capital, a Los Angeles-based middle-market lender, is seeing a rise in demand for loans of roughly $5m to $25m. There are a lot of 1031 exchange investors who are rolling money from multifamily deals into office acquisitions in search of higher stable cap rates," said **Felix Gutnikov**, principal and head of originations. These investors are generally selling multifamily properties at cap rates of 4% to 5% and transitioning to office properties that have the potential to offer higher cash-on-cash returns, he added.

"A lot of the older office product is being converted into creative properties. We're seeing more institutional capital coming into this market and we're seeing properties in submarkets like Long Beach and Pasadena trading at historically high prices per square foot," Gutnikov said.

The firm has seen an uptick in demand for bridge loans for value-add office properties, due in part to aggressive competition from regional banks and **Fannie Mae** or **Freddie Mac** for apartment loans, where non-bank lenders cannot compete effectively due to their higher cost of capital. Loans of $50m and up are generally priced in the mid 200-300 basis point range over LIBOR while loans of less than $50m can typically achieve higher spreads at one-month LIBOR plus roughly 350-425 basis points.

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