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Downgrade Doesn't Disturb Big-Game Hunt for Property

REAL ESTATE: Capital Is Still Key to Capturing the Bargains; Credit Crunch May Hurt Others

■ By LOU HIRSH

Local property investment experts say the recent **Standard & Poor's** downgrade of U.S. government debt will likely trim the overall ranks of financing sources to get deals done, and slow down the recent pace of price appreciation on attractive

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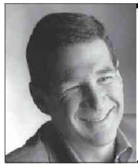
commercial properties.

But that won't necessarily stop some well-capitalized firms from seeking out bargains in what remains a shaky economic recovery.

"We tend to thrive on dislocation in the market," says **Mitch Siegler**, senior managing director of San Diego-based **Pathfinder Partners LLC**. In late July, the firm acquired a lender-owned, 120-unit apartment complex in Mesa, Ariz., for $5.4 million, less than two weeks after purchasing an 84-unit Arizona condo development under similar distressed circumstances.



Mitch Siegler

Since 2006, Pathfinder has acquired more than $350 million in defaulted commercial real estate in seven states. That includes Eastlake Medical and Professional Center in Chula Vista, which it bought at an April foreclosure sale for $4.6 million in cash.

Opportunity for Some

If the recent debt downgrade causes credit to tighten, and owners are forced to sell off properties to get some cash liquidity, there could be more opportunities for well-funded buyers to snap up multifamily, office and retail properties, Siegler said.

While continued low interest rates should help make acquisitions feasible, he said there remains a "tale of two cities" climate for credit availability — with big real estate investment trusts still finding ample funding options, while smaller businesses struggle to get financing as banks remain selective in their lending.

With their own credit recently being downgraded, the nongovernment agencies Fannie Mae and Freddie Mac also may be reducing their involvement in certain kinds of investing, including multifamily projects. Siegler said that means other types of investors may need to step forward to fill the void.

At Beverly Hills-based **Omninet Capital LLC**, which last year announced plans for $100 million in San Diego area commercial investments over the next few years, Managing Partner **Benjamin Nazarian** said the firm's strategies were not impacted by recent turmoil set off by the debt ceiling debate and subsequent S&P downgrade.

The company is scouting for follow-ups to recent local acquisitions including the Rancho Serra Mesa retail center and Sky Park Business Center, both in Kearny Mesa, with a total value of approximately $16 million.

However, Nazarian said that some buyers may find it more difficult to get financing through commercial mortgage backed securities, also known as CMBS, which essentially are commercial mortgages bundled together and issued as bonds. Fewer CMBS loans being issued could in turn have a dampening effect on real estate values.

A Climate Change

"The bigger impact is the realization that the economy has slowed down," Nazarian said. "Therefore, investors will be more conservative in pricing properties because they can no longer assume significant rental growth for the next couple years, as they were doing just six months ago."

The larger issue for commercial real estate could be the negative hit to consumer psychology delivered by the D.C. debt debate, government downgrade and the resulting stock market upheaval.

Mark Riedy, executive director of the Burnham-Moores Center for Real Estate at University of San Diego, said continuing uncertainty about the domestic and global economies will likely keep demand in check for new office and retail buildings.

Well located commercial properties could continue to see prices bid up by multiple suitors, amid the "flight to quality" that began several months ago amid a lack of new construction. However, he said housing demand could be squelched for several more years, and skittish companies won't be expanding their office space needs significantly for some time.

There may be pockets that recover more quickly, but overall real estate demand conditions may not return to normal until 2013 or 2014 at the earliest. The Federal Reserve's pledge not to raise interest rates could help prevent things from getting worse in the next two years, but the Fed has exhausted its options for spurring improvement now that borrowing rates are as low as they can get.

Risk-averse consumers and businesses could remain on the sidelines as long as there is no agreement in Washington about how to proceed next.

"Things would otherwise be ripe for a recovery with these low interest rates, but right now there's just no spark," Riedy said.

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