

Real estate moves at fire-sale prices

*As values slump, market for
commercial properties tilts
heavily in favor of buyers*

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Albuquerque Journal*

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The pending sale of the University Towers office building at a fire-sale price captures one of the dynamics in commercial real estate right now.

The University of New Mexico has a contract to buy the empty, 99,033-square-foot building at 1650 University NE for \$4.6 million, a steep 44 percent discount from the asking price of \$8,250,000 just one-and-a-half years ago. The property had gone into foreclosure.

“We think it’s a pretty fair deal,” said Tom Neale, associate director of real estate at UNM. “We’re really focusing on the building and what it will take for us to renovate and upgrade the (building) systems.”

UNM’s purchase of the building is not a done deal. “We still need to go to the regents for approval of the transaction,” Neale said. “We’ll do that when we’re satisfied with our building assessment.”

The assessment includes exploring

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different uses for University Towers and whether it fits the university's need for space. Potential occupants might either be university operations in leased space now or located on the main campus, he said.

If the assessment goes well, the purchase could close in June, he said. Part of that assessment also is to determine the best way to finance it and whether the university could save money by relocating other operations. "There are a number of options, we just have not settled on the best option," Neale said. "There are a number of sources outside state appropriated funds."

The 44 percent discount in price illustrates a trend in commercial real estate where sales of distressed properties are driving down property prices. Because of problems in the broader economy affecting rents and occupancy, coupled with tight credit for investment purchases, the sales market for commercial real estate has tilted heavily in favor of the buyer.

Huge drops in value

Commercial properties of all types have dropped 40.2 percent in value nationwide from the peak in October 2007, according to the Moody's/REAL All Property Type Aggregate Index. The three most recent months of the index, November through January, have shown some improvement since the index hit bottom at a 43.7 percent decrease in value last October.

Commercial property values have been sliding in the Albuquerque metro area, but not nearly as much as the national average.

Local values have dropped by an average of 27 percent since October 2007, according to an informal poll of six commercial real estate experts. In line with the national trend, the average value has been dragged down by the low prices in fire sales of distressed properties.

University Towers is a classic example of a distressed property.

The five-story building formerly housed various back-office and



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Central New Mexico Community College purchased the former Motorola industrial campus, shown here, at a bargain price after it had gone into foreclosure.

administrative functions of UNM Hospital. In September 2008, UNMH relocated those operations to a 141,520-square-foot, university-owned building at 933 Bradbury SE in UNM's Science & Technology Park.

Attempts were made to either lease University Towers or sell it for the \$8.2 million asking price by CB Richard Ellis, which was marketing the property for owner DBSI of Boise, Idaho. The commercial real estate market was already in slowdown mode and, with the loss of its major tenant, University Towers had lost its value for an investor purchase, said CBRE's Patti Peixotto.

"Everything in investment real estate is tied to cash flow," she said, adding that without any tenants, "the building only had value for a potential user."

DBSI, which had bought University Towers in late 2004, filed for bankruptcy court protection in November 2009. Ownership of the building reverted to the group of investors who had backed DBSI's original purchase. Eventually the lender, Wells Fargo, foreclosed on it.

Just part of the appeal

The fire-sale price was only part of University Towers' appeal to UNM. The property is adjacent to the eight acres surrounding the former Elks Lodge, which the university owns. And

further to the south, the Elks Club site is next door to the UNM Continuing Education Complex at 1634 University NE.

"It's a strategic parcel for us as the university grows," Neale said.

UNM is an institutional buyer, a category of real estate buyer that is bolstering commercial real estate activity both here and around the country. The recession-resistant institutional category also includes hospitals and health care systems.

In a comparable purchase two months ago, Central New Mexico Community College bought the former Motorola campus – home to CTS since 1999 – at the southwest corner of Alameda and Jefferson NE. The property, which consists of two industrial buildings on 20 acres, was also in foreclosure at the time of the \$10 million purchase. CNM plans to renovate the smaller, 81,419-square-foot building into labs for programs in its School of Applied Technology. CTS, which makes electronics components, will continue to lease just over half of the larger, 165,581-square-foot building.

CNM's purchase and UNM's pending purchase also illustrate the current emphasis among lenders to provide financing for the purchase of property that will be owner occupied. In most of those cases, the loans are guaranteed by

UNIVERSITY TOWERS BUILDING



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the income of the business or institution making the purchase.

Investor purchases, where loans are guaranteed by lease payments, have become few and far between around the country but especially in Albuquerque. The chief reason is commercial property values haven't dropped enough here – the estimated 27 percent decline versus 40.2 percent nationwide – for the bargain deals that investors now seek.

"We're seeing a lot of entrepreneurial investors out there," Peixotto said. "We just can't compete because we haven't seen the values decline like they have in Southern California or Florida and places like that."

The best way to explain why values haven't declined as much here as nationwide is to look at the recent past, said Dan Hernandez of Berger Briggs Real Estate and Insurance.

During the years leading up to the October 2007 peak in values, commercial real estate escalated in value throughout much of the country, he said. The escalation was due largely to frenzied buying and selling, fueled by comparatively lax lending, as investors sought higher returns in real estate than they were getting in the stock market.

"Values were going up here, but not like they

were across the board," Hernandez said. "That's why we're not seeing them crash."

If commercial real estate has lost an average of 29 percent in value in Albuquerque and an average of 40.2 percent nationwide, then values are roughly where they were in 2003.

"The '07 values were overinflated," said Jim Chynoweth of CBRE. "What we may have lost in value offsets the steepest increase in values over a four-year period that our market has ever seen. You're comparing against an all-time peak."

Values in context

The huge drops in average commercial property values are not as bad as they appear at first glance.

A lot of factors go into determining the value of commercial property. A well-maintained property with a good location has probably lost only 10 percent to 12 percent of its value if it's close to fully leased to tenants with long-term leases, both Peixotto and John Lewinger of Grubb & Ellis New Mexico agreed.

"If you look at a nice, occupied, active building and think, 'The value has dropped 29 percent' – that's not right," Peixotto said.

The same property with 30 percent of its space vacant, for example, may have lost 15 percent to 20 percent of its value due to slashing its asking lease rates to lure in new tenants to fill the vacancy. From there, each black mark or demerit against the property – higher vacancy, deferred maintenance, challenging location – reduces the value.

But the huge drops in value are only on paper if the property owner isn't in a hurry to sell, said Keith Meyer of Maestas & Ward Commercial Real Estate. Patience, or more precisely a sufficient cash flow to be patient, is a key for owners wanting to sell in the current market conditions.

"If you have to sell it for cash in 30 days, that's a totally different ball game," Meyer said. "You're changing the rules. There's very few buyers out there who can move in 30 days. That's what distorts the market."

And that's the essence of a distressed property sale.