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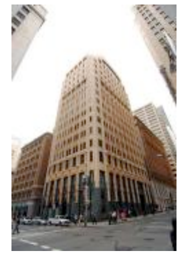
Sale shows San Francisco property values in free fall

Office building down 57 percent off peak

San Francisco Business Times - by J.K. Dineen



Spencer Brown

Half off: Value of 250 Montgomery plunged since 2006.

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A downtown San Francisco office building that sold for $400 a square foot in 2006 has traded for just $172 a square foot, a 57 percent decline that industry experts see as an important milestone in establishing new, recession-era values for financial district property.

A private equity fund controlled by an unidentified "domestic billionaire" has paid $19.9 million for 250 Montgomery St., a 116,000-square-foot building on the corner of Pine Street that **Lincoln Property** Co. bought for $46 million in 2006. Technically, the buyer bought the note on the building, rather than the property itself. Under the sales agreement the lender on the property, **Finance Realty Corp.**, will deed 250 Montgomery St. to the buyer in lieu of foreclosure. Lincoln Property was in default on the property.

The sale, at a price that represents about 25 percent of replacement cost, represents the first San Francisco office building sale in a year. It is also the first "round trip" transaction where a property went from being sold at the peak of the market to deed in lieu of foreclosure to a new owner. **Colliers International** Executive Vice President Tony Crossley said the price "gives the market a data point it has been lacking."

"This gives a benchmark that other owners and lenders can point to as saying this is what real estate is now worth in San Francisco and can adjust to accordingly. People can now look at their own building and say with more certainty what it is worth. It takes the nonsense out of it," he said.

The transaction was completed in less than a week, according to one brokerage executive who didn't want to comment because his firm was involved in the transaction. There were a dozen offers with some well below $100 a square foot. Dan Cressman of **Grubb & Ellis**, who represented the buyer, declined to comment.

"The speed of this was wild. It was incredible," said a broker familiar with the process. "You had these guys coming out of the woodwork. These are guys who didn't invest last time. They have cash. They are long-term buyers who will double their money on the way out."

The low sale price was partly driven by the building's high vacancy rate — it is less than 50 percent occupied — as well as some deferred maintenance. Crossley estimated that it could cost an additional $70 a square foot — about $8 million — to make the building attractive to tenants. Even with the additional investment, the deal is a steal, Crossley said.

"If they are into it for $240 a square foot stabilized and leased, that is a pretty darn good purchase," he said. "It's purely buying on a price-per-pound basis. It doesn't have a lot to do with cap rate."

Tony Natsis, chairman of the real estate department at the law firm Allen Matkins, said the majority of buildings sold between 2005 and 2007 are underwater, meaning that the debt on the building is more than the asset is worth. While real estate observers are focused on maturity dates, Natsis said the majority of lenders — both those who have kept the loans on their balance sheets and those who have syndicated the loans — are working to avoid foreclosure.

"What is really happening is that the (commercial mortgage backed-securities) guys are starting to extend and the balance sheet guys are starting to extend," said Natsis. "If the guy is otherwise current, why would you want to own the building?"

Meanwhile, owners who are underwater are unwilling to invest in the sort of tenant improvement packages necessary to attract tenants, Natsis said, creating "zombie buildings" where leasing deals are not getting done.

"The question for many owners is why would I throw $8 million out of my pocket in a building because I would be throwing good money after bad?" he said. "I'm not going to feed the building. It's like the living dead. Everything is a three-part negotiation now between the landlord, the tenant and the lender. And until the lender does something, the building is frozen."

Natsis said the majority of downtown office building foreclosures will be friendly.

"If you give back an asset in an orderly, kind fashion, you will be forgiven," said Natsis. "It's not a death knell these days."

With 250 Montgomery St. now sold, brokers and investors are turning their attention to 333 Bush St., an office building that lost its anchor tenant when the law firm **Heller Ehrman** dissolved last year. Owners **Hines** and Sterling are in the process of giving the property back to lender **Brookfield Asset Management**, according to multiple sources. Brookfield is already managing the building. It hired the **CAC Group** to lease it.

Katherine Vyse, senior vice president of investor relations for Brookfield, said the REIT has a "mortgage loan on the property, but we do not own the building today."

Natsis, who is Brookfield's attorney, declined to comment on the 333 Bush St. situation.

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