

Commercial Real Estate

Smaller funds see opening as big players exit, prices drop

October 26, 2009

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When Gustaf Arnoldsson began courting potential investors to form a real estate investment fund, he felt like a high school student worried about arriving late to the dance.

But Arnoldsson, managing member of Miami Beach's Stonemason Partners, discovered in the middle of 2008 that he was alone on the dance floor. Few investors in South Florida expected the crisis ahead, he said.

"I started seeing the signs everywhere that the market was going to head down," Arnoldsson said. "Most people buying real estate were turning it into a financial play rather than a real estate play. Like the tech bubble early this decade, people were buying based on potential future earnings."

Now Arnoldsson and Stonemason are no longer alone. Other moderately sized companies, some formed by longtime players in the region, are raising money to acquire commercial real estate in South Florida.

Stonemason has a \$35 million bankroll and goal of buying \$100 million worth of multi-tenant commercial properties in the next five years.

Funds like Stonemason's are comprised mostly of high net worth private investors, not large public institutions. Stonemason reached out to investors from Florida, New York and northern California.

"There are no institutional investors at this point in time," Arnoldsson said.

For now, acquisitions remain difficult to complete, Arnoldsson said. Since launching the fund, Stonemason's only purchase has been a seven-unit apartment complex in North Bay Village for \$823,000.

"Today people are trickling into the party," he said. "But it still has not gotten started. The deals being presented to me are not worth buying at any price."

Like Stonemason, veteran South Florida investment company Foxcode Real Estate is raising money to take advantage of significant property discounts. Foxcode, based in Miami, announced earlier this month the launch of a fund that plans to raise \$50 million to invest in Florida and other East Coast markets.

Foxcode president Robert Willis did not return calls seeking comment.

One investor, Dizengoff Trading Group, has arrived all the way from Israel. Dizengoff, a real estate development and commodities firm, chose South Florida for its first U.S. branch because of the abundant opportunities, said Ronen Saban, U.S. region manager in Dizengoff's new Boca Raton office.

"We have been learning this market since 2005," Saban said. "No one knows exactly when this market will turn around, but from a long-term investment perspective, this is a perfectly good time to buy."

Dizengoff has made two purchases in the region since July. The company bought the fully-leased Shoppes at Monarch Lakes, which is anchored by Publix, in Miramar for \$8.29 million. It also acquired the fractured condominium project Portofino in Jensen Beach, which is being operated as a 118-unit rental complex, for \$6.75 million.

SEIZING THE OPPORTUNITY

More than \$130 billion of commercial mortgages are in default, foreclosure or bankruptcy in the U.S., according to Real Capital Analytics.



Gustaf Arnoldsson



The investment market has opened up for these smaller funds because large vulture funds are struggling to complete deals. Despite the abundance of distressed properties, major vulture funds are finding resistance from banks that are working out deals with many borrowers instead of foreclosing.

A \$5 billion vulture fund formed in August by the Canadian company Brookfield, which planned to invest heavily in the U.S., has yet to make a purchase, according to the Wall Street Journal.

While there has been a flurry of note sales recently, many banks are not willing to take a major haircut by selling off notes for South Florida properties at discount rates, Arnoldsson said.

“Nobody in the lending world is ready to take the hit yet,” he said. “They are just looking to kick the rock down the street. Banks are not moving anything and the inventory is building up on the books.”

But with the future in mind, companies like Stonemason and Dizengoff are cultivating relationships with South Florida lenders knowing they will ultimately have to find buyers for their distressed assets.

Before joining Dizengoff, Saban was Boca Raton branch manager for Israel-based Bank Leumi. Saban says his contacts in the South Florida lending community are giving the company a leg up in potential deals with banks.

“Banks are more strict while looking to liquidate a lot of their assets,” Saban said. “It is important to cooperate with them and create a relationship in good standing. You can get a much better deal with banks right now.”

Dizengoff has signed a contract to purchase another fractured condo project from a bank and expects to close on the purchase within 45 days, Saban said. He declined to disclose the property or price prior to closing.

Deals are not moving as quickly as some investors initially expected because banks, while burdened with numerous distressed properties, are facing larger issues than individual assets, said David Moret, principal at Coral Gables-based Continental Real Estate Cos.

Moret said he is spending much of his time working with lenders on “exit strategies” for distressed properties.

“Lenders have capital requirements, and every lender has different situations with the [Federal Deposit Insurance Corp.], Moret said. “There was a massive increase in defaults during this cycle. Banks are in the early stages of working through securitized debt issues.”

Vulture funds that planned to buy properties are dropping out of the market, creating more opportunities for investors like Stonemason and Dizengoff.

Moss Capital founder Bill Moss, a former executive at Macquarie Group, told the Wall Street Journal that the best time for vulture funds to buy cheap properties has passed. The fall of 2008 was the optimal time to strike, Moss said.

But potential discount deals do exist for companies that are not in a rush to make purchases and can hold onto properties for the next five to 10 years, Arnoldsson said.

“We are taking the conservative approach of spending five years investing and five years holding,” he said. “Our investors have a long-term horizon. About 60 to 70 percent of our acquisitions will be retail centers with strong demographics.”

Dizengoff has similar investment criteria, Saban said.

“We want positive cash flow from day one,” he said. “We are not looking for vacant property.”

Foxcode also seeks to buy commercial and multifamily properties with strong cash flow potential at below market prices, according to the company’s Web site.



Today's investors also have to be ready to pump money into purchases to maintain the steady cash flow, Arnoldsson said.

"You have to inject capital and improve the property to put it back on the market," he said. "That way you can lease to tenants and return enough money so it is a good solid investment."

A flexible long-term investment strategy makes sense for these funds, said Jay Caplin, managing principal at Steelbridge Capital in Miami.

But while Stonemason has already raised significant money, funds like Foxcode's that have yet to secure investors may have trouble, Caplin said.

"It is a very challenging environment to raise a fund given the broader economy," he said. "There are issues with people's sense of when the market will bottom out and whether it is a good time to invest or not. There are still some trust issues as well with people who invest blindly in pools after the high-profile cases of [Bernard] Madoff and [R. Allen] Stanford."