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From the Los Angeles Times

## LENDING

### Credit woes hit office market

Credit woes hit commercial real estate market

By Roger Vincent

Los Angeles Times Staff Writer

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The global credit crunch that has rattled financial markets the last few weeks is finally reaching the vast commercial real estate investment and development industry.

Predictions by some analysts that prices are poised to drop for office buildings and other commercial properties are sending shivers through the business, driving down real estate company stock prices and delaying some deals.

"We are seeing fewer people at the table, but when it comes to the best buildings, there are still plenty of people who want to buy them," said John Cushman, chairman of real estate brokerage Cushman & Wakefield.

But bidders who have been borrowing heavily to leverage property acquisitions are falling away as lenders shut out marginal players, Cushman said. So far, though, the long-robust market has cooled but not collapsed.

Instead, doubt reigns as many buyers and sellers wait to see what is going to happen to the economy and whether it will continue to get more difficult and expensive to borrow money, Cushman said.

"There is just a lot of uncertainty and volatility in the market," he said. "The dust hasn't settled yet."

Archstone-Smith Trust in August postponed its \$13.5-billion sale to a group led by Tishman Speyer Properties until October. Mission West Properties Inc., owner of commercial buildings in Silicon Valley, said Aug. 13 that the company's \$1.8-billion sale might fail after a bank withdrew funding.

Southern California has emerged as one of the country's top markets for real estate investment in recent years, with institutional and individual investors betting that its economic growth will continue to support property appreciation.

Last month a Houston real estate investment trust paid \$287 million for the One Wilshire office building in downtown L.A. and a local investor spent \$200 million to acquire Sunset-Gower Studios in Hollywood.

But the same angst affecting the rest of the country is being felt here.

Keeping the market alive are deep-pocket investors such as pension funds and insurance companies that can still get loans to buy expensive real estate, said Robert White, president of real estate data provider Real Capital Analytics.

Nevertheless, he said, the recent increases in the cost of borrowing money stand to make pending real estate purchases less profitable in the long term, prompting some buyers to walk away or to try to negotiate a lower price.

"There has been a spike in the last 30 days of deals falling out of contract," White said. "People planning to close deals last month got hesitant."

Many buyers are now in a wait-and-see mode, he said. If the market calms and borrowing gets easier in coming weeks, they'll go ahead with their purchases. If lenders are still queasy about funding real estate deals, most buyers will have to decide whether to bail out or go ahead and take a financial haircut.

"There aren't a lot of pressured sellers out there. It's not like the residential market," White said. "If they can't get their prices now, they can afford to wait. Probably a lot of assets just won't trade."

The commercial real estate market is on firmer footing than the residential market, said Brett White, president of Los Angeles-based brokerage CB Richard Ellis, the largest in the world.

"The fundamentals behind the business remain very strong," he said.

Owners are raising rents because buildings are filling up as tenants expand businesses. And even though the real estate market has been steadily improving for the last few years, developers and their financiers have resisted the temptation to erect offices and warehouses unless they have tenants ready to move in.

A wave of speculative construction in the late 1980s and early '90s led to a crash in the office market that the industry recovered from only in recent years. Downtown Los Angeles was particularly hard hit.

Another difference from the residential market is that "the delinquencies in commercial mortgages are virtually zero," White said. "We're seeing virtually no delays or defaults."

Like residential real estate, though, the question of what's going to happen to prices remains a hot topic.

"We have been in an incredible bull run in the past five or six years with hefty annual appreciation," analyst Robert White said. "That has stalled."

Average prices for commercial properties might drop 5% to 15% in the next two years depending on the type of property and its quality and location, industry analyst Matthew Ostrower of Morgan Stanley told Bloomberg News.

Some sellers are wavering, said Wayne M. Brandt, managing director of commercial lender RBS Greenwich Capital. Many lenders expect to see office values dial back 5% to 10% from their historic highs of early spring, he said.

Overall values were driven up by expensive office portfolio sales, most notably the \$23-billion acquisition of Equity Office Properties Trust by Blackstone Group in February.

"Some of the air is coming out of that right now," Brandt said.

However, experts including Brett White and Robert White predict that most price deflation will occur on lower-quality buildings in smaller cities that don't tend to appeal to institutional investors.

"I am more bullish on Southern California than others may be," New York-based Robert White said. Both regional and foreign investors are still keen on investing here, he added.

But those Wall Street investors worried that the credit crunch would cork the flow of real estate transactions are punishing public real estate companies with large brokerage divisions. Stock prices for both CB Richard Ellis and Grubb & Ellis have skidded downward in the last month.

"They're just getting creamed," analyst Craig Silvers of Bricks & Mortar Capital said. "Investors think there will be a big slowdown in commercial sales."

He says the industry is still strong and the environment is good for well-financed investors who don't have to bid against heavily leveraged competitors.

"The frenzy is all gone," Silvers said, "but the commercial market is not in decline."

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