

# Fuel Gauge

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# Getting Creative With Office Inventory

By Anna Spiewak

So you're a zealous property investor hungry for a high return on investment. But the competition on all core and core-plus value-add assets is fierce, cap rates have plummeted, and new development is nonexistent.

What do you do?

Invest in a vacant building, of course!

According to a new publication by Transwestern—*Insights, Trends, Opportunities*—in light of a surging economy that is expected to drive growth in commercial real estate, vacant

office buildings have become more attractive to investors.

Returns on office investments continue to decrease in markets with the most economic improvement, especially in technology and healthcare hubs experiencing steady job growth. As a result, investors are willing to accept more risk and pay higher prices for vacant or nearly vacant office buildings, as well as those that are about to empty out, according to Transwestern.

"We're in an environment where a lot of markets are supply constrained, so as a re-

Blue Star Properties purchased a vacant building in downtown Chicago and rebranded it The National, a creative office space.

sult, people are looking for creative ways to bring new office inventory to market," Sean Coghlan, director of investor research with JLL, told *Commercial Property Executive*.

Mainly taking place in the nation's largest markets with improving fundamentals, this trend is driven by lower returns on stabilized assets because of com- (continued on page 16)

## CPE 100 QUARTERLY SENTIMENT SURVEY

### Why We Go Green

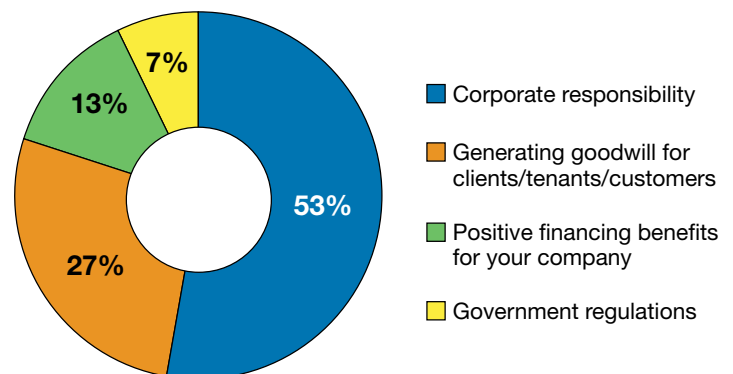
The results of our first quarter 2015 polling of the CPE 100 executive board show that sustainability initiatives continue to be a big focus for the industry. Forty percent of executives polled said sustainability is very important to their company's strategy, while nearly 30 percent said it was somewhat important. The most important factor driving sustainable initiatives turns out to be corporate responsibility (53 percent of the vote), followed by general goodwill for clients, tenants and customers (27 percent of the vote).

We also used this survey to examine any connection between lower oil prices and sustainability strategies. The overwhelming majority (nearly 80 percent) said that lower energy prices have had little or no effect on sustainability practices. Roughly 15 percent of those polled did note that declining oil prices make energy less expensive, so conservation is less urgent.

Our recurring questions covering the health of the economy, industry and individual companies remained relatively unchanged from last quarter, with a slight majority of executives seeing conditions unchanged over the next three months. The remainder expect things to improve slightly.

—Mike Ratliff

### What is the single most important factor in driving your company's sustainability strategy?



Source: CPE 100 Quarterly Sentiment Survey, 4Q 2014

For more survey results, click through to [CPE's Research Center](#).

# Getting Creative

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petition and an increase in debt sources willing to finance opportunistic acquisitions.

Also due to investor competition, cap rates on the best office properties in the top six U.S. markets have dipped to an average of 4 percent, down almost 50 basis points in 2014, according to Real Capital Analytics Inc. As a result, investors are looking where they can bring value to chancier projects and meet the return profile.

And to increase their returns, some lenders have been open to financing the acquisition of vacant properties, offering interest-only debt fund financing at 65 percent loan-to-value in addition to 100 percent of cap-ex funding. Terms are improving because more debt sources are loaning on these non-core assets.

"You're seeing more institutional money willing to invest in vacant buildings. We've bottomed out and we're cycling upward—that's why you're seeing a pick-up in demand for vacant buildings," noted Gerry Trainor, executive managing director of the capital markets for Transwestern, who recently brokered the sale of a vacant property to an office investor.

According to Transwestern, vacant prop-

erties have also become acquisition targets for investors that want to repurpose them for other uses, such as multi-family, hotel rooms and retail spaces, especially in urban, transit-oriented areas.

But CRE experts contend that investors usually seek vacant office buildings with the intention of repositioning them and leasing them back up. "Most buyers are looking at properties that have a block of vacancy. They look at how they can potentially put capital back into them and reintroduce them into the market to make them attractive to creative tenants," Coghlan explained.

Transwestern anticipates an uptick in the purchase of vacant, opportunistic buildings as returns for core and value-add spaces continue to decline. However, according to these risk-taking investors, there just aren't too many vacant buildings to go around.

## Risk Takers

Who are these risky investors taking chances on vacant properties? According to experts, it's definitely not any of the foreign capital coming into the country. Foreign investors mainly grab core and core-plus assets, which tend to carry lower risk. Instead, these properties are attractive to creative investors that don't mind sticking their necks out.

Craig Golden, Blue Star Properties founder

## News Behind the Trend

Transwestern's Insights, Trends, Opportunities 1Q 2015 report

& principal, is one such investor. In the office-building business for the past 25 years, he seeks out vacant properties.

"I always used to say, if a building is 40 percent vacant, it's perfect," he said, laughing.

The Chicago-based real estate company recently bought the vacant former Chicago Public Schools headquarters in the Windy City's Central Loop, built in 1907, with the intent of converting it into office space for tech companies and creative agencies. Work recently commenced on the property—re-named The National—with completion slated for the fourth quarter of 2015.

Golden agrees that taking a chance on a completely vacant building is a gamble, but he's convinced that the right partnership and a bit of patience can go a long way with such a project.

"It's the reward part that you take the risk for. (We'll) create a lot of value on the back end if we can succeed with what we're doing," he added.

CPE

## INVESTORS UNAFRAID OF VACANCY



The largest tenant in an office building at 311 W. Monroe St. in Chicago (BMO Harris Bank) vacated 250,000 square feet in December 2014.

CAUSE → EFFECT

The 15-story asset sold in the fourth quarter of 2014 for \$58 million to buyers that knew it would be 82 percent vacant.



Prominent Murdoch Plaza at 10900 Wilshire Blvd. in L.A. was only 48 percent leased.

CAUSE → EFFECT

The 237,000-square-foot office building was purchased last year for \$125 million.

The trend stretched to suburban markets, when an investor bought a 100,000-square-foot vacant building in a St. Louis suburb, confident it could attract a large occupant, because of its especially high parking ratio of 8/1,000.

CAUSE → EFFECT

The buyer secured a full-building tenant on a 10-year lease in less than a year with two other tenants vying for the same space. The asset eventually sold to a net-lease investor.

Source: Transwestern