

Dry powder piles up

More than \$50 billion raised to invest in distressed property, but many funds may be disappointed

By Candace Taylor

New York City is at a peculiar crossroads. For months, investors have marshaled unprecedented amounts of capital, salivating at the prospect of snapping up distressed properties.

"We're fortunate this cycle to have the most dry powder in our history," Blackstone Group president Tony James said last month at the Barclays Capital Global Financial Services Conference, which was held in Manhattan. The firm has about \$28 billion in unspent capital, he said. About \$12 billion

"There's no way all this capital is going to get the type of returns they're looking for," Fasulo said. "A lot of these funds are going to be disappointed."

Already, some funds have begun returning capital to their investors.

This month, *The Real Deal* looked at these vast deposits of unspent capital, examining who has them, where they came from and where they'll likely be spent.

Some of the most active players are old-time real estate families — cash-rich property owners looking to buy again after years of

quently, said Ofer Cohen, founder of boutique commercial brokerage TerraCRG.

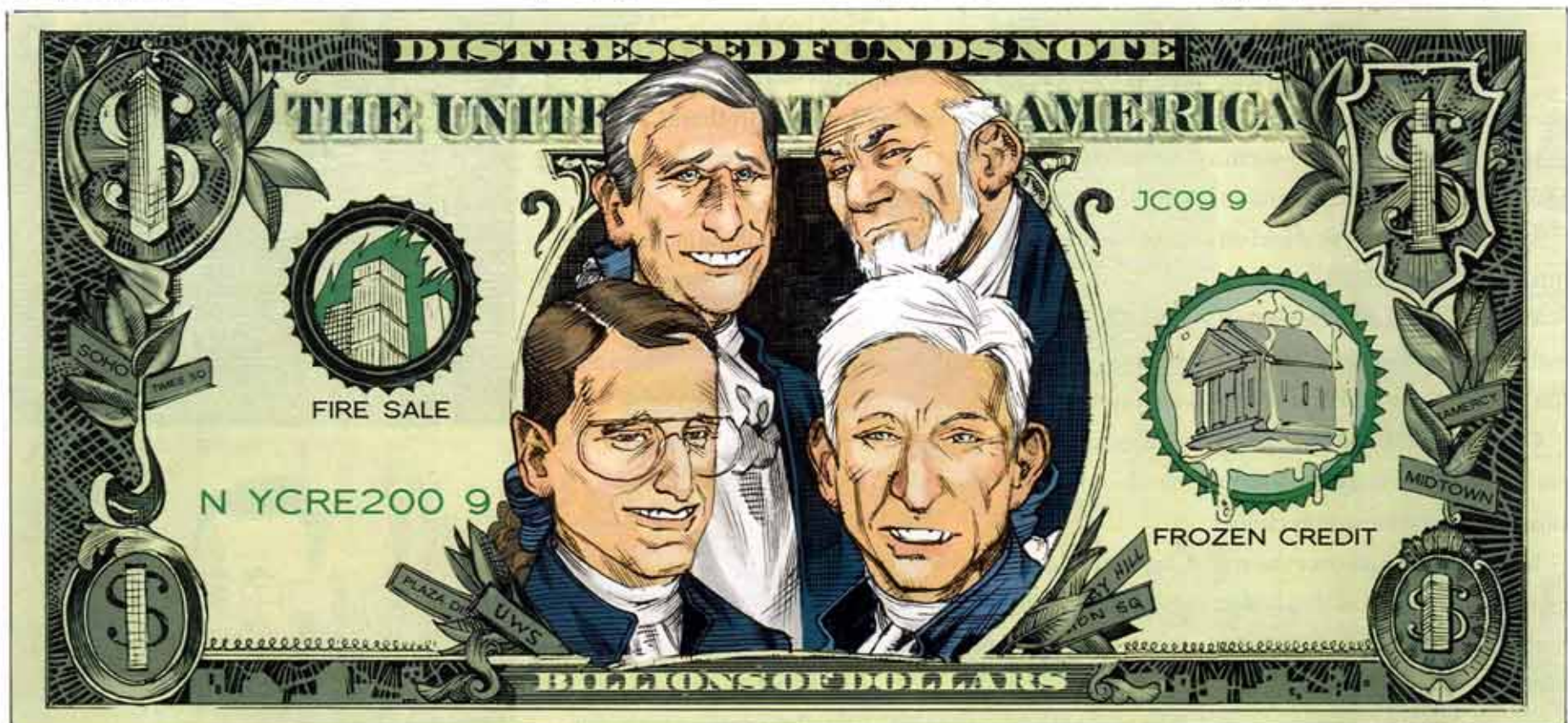
Cohen recently handled the sale of 392 Atlantic Avenue in Boerum Hill, Brooklyn. The foreclosed-on piece of improved land was originally purchased in 2007 for \$990,000 with a loan of \$740,000. The lender sold it at \$610,000 after a 30-day bid process, Cohen said.

"Smaller or local banks are more proactive about either unloading bad debt or taking over the deeds on distressed notes and disposing [of] them," Cohen said.

Meanwhile, Richard LeFrak, CEO of the LeFrak Organization, told *The Real Deal* in February that for the first time in 15 years, the company has no new construction projects under way in the New York area.

The reason? The traditionally conservative company was spooked by the frenzied mid-2000s market, which "brought land values up to unrealistic price levels," he said.

LeFrak said the company — which is perhaps best known for its massive Queens housing complex, LeFrak City — had been scooping up properties in the Los Angeles area,



Clockwise from top left: Stephen Schwarzman, Sam Zell, Stephen L. Green and William Mack are among those who are looking to buy distressed New York City properties.

of that is earmarked for real estate.

"We're just beginning what will be the best period in decades for private investing," he said.

Dan Fasulo, a managing director at Real Capital Analytics, estimated that \$50 billion has been raised and is ready to be deployed into distressed real estate. Paradoxically, investors have found very little worth buying so far, in large part because banks continue to hold troubled loans on their books, hoping conditions will improve.

The result is a marketplace where the few distressed assets that come to market are met with a frenzy of interest from potential buyers.

"This money is chomping at the bit," said David Schechtman, a senior director at brokerage Eastern Consolidated. "Whatever I bring to market, I am inundated with calls, even when it's not an 'A' location."

This standoff likely won't continue indefinitely, but experts say there won't be enough properties to satisfy the massive amounts of capital accumulating on the sidelines.

dormancy. Other local operators are backed by funds like Westbrook Partners and AREA Property Partners, who've been busy raising capital from all over the world. Then there are high-net-worth individuals like billionaire Sam Zell, who just announced a \$625 million fund to buy distressed securities backed by commercial real estate and other assets. Finally, big-money players, including REITs like Boston Properties and major international companies like the Blackstone Group, headed by chairman Stephen Schwarzman, are also searching for deals in the Big Apple.

"We're seeing institutional money back in play again really for the first time in probably a year," said Ken Krasnow, a managing director at Massey Knakal Realty Services. "That's a big disparity from a year ago, when institutional money was completely on the sidelines."

Small deals, big interest

While large deals are still rare in New York, smaller properties are trading more fre-

quently, said Ofer Cohen, founder of boutique commercial brokerage TerraCRG.

"You're seeing people like the LeFraks, the Rudins, the Fishers, the Dursts — those kinds of families engaging in the market today," said one industry veteran, adding that many of these families haven't acquired New York property in years. "Two years ago, these guys weren't even playing, they weren't even in the discussions. Now they're active."

"They didn't overleverage, didn't go crazy," the source said.

For example, family-owned Manhattan firm George Comfort & Sons — previously under the radar — made headlines when it led an investment group that purchased the last building in Harry Macklowe's distressed portfolio, Worldwide Plaza, for \$590 million in July. The firm, which *The Real Deal* profiled in last month's issue, now operates eight office towers in Manhattan and is looking to acquire distressed assets in Midtown, Lower Manhattan and other markets.

but plans to start looking in New York again once prices "readjust." While that doesn't appear to have happened yet, the LeFrak Organization is part of a group of investors committed to buying \$1 billion in distressed bank assets through the U.S. government's Public-Private Investment Program.

The Dursts, too, are a long-standing real estate family, known for developing 655 Third Avenue in 1958 and 1133 Sixth Avenue in the late 60s. In the late 1990s, fresh from the success of 4 Times Square, they started planning the 2.1 million-square-foot Bank of America Tower at One Bryant Park, breaking ground in 2002 and leasing it up just before the current downturn hit. Now, not only do they have their own money to spend, but they have announced plans to raise a \$300 million fund to invest in distressed real estate. Little of that money appears to have been spent to date, however.

Another local company, Murray Hill Properties, is also on the lookout for good deals. The firm, which focuses almost exclusively on Manhattan office buildings, recent-

WHO HAS THE MONEY?

ly closed a \$100 million fund and "we've only spent a third of it," said Norman Sturmer, the company's co-founder and CEO. The firm used part of the money to buy out its partners at 1412 Broadway, he said.

The trade publication Real Estate Alert reported that Murray Hill Properties is seeking to raise a new \$500 million fund to give it even more investing firepower, though Sturmer declined to comment.

Another crucial segment of the marketplace is composed of high-net-worth individuals like billionaire Sam Zell. An industry veteran who sold his Equity Office Properties Trust to Blackstone for \$39 billion in 2007, Zell has earned the nickname the "Grave Dancer" for his ability to profit from distressed assets. Undeterred by the bankruptcy of media company Tribune Co., which he bought for \$8.3 billion, he's now getting back in the real estate game and has filed plans for a private-equity fund called Zell Credit Opportunities Fund LP.

Finally, brokers say there is also a bevy of very low-profile landlords looking to buy discounted New York properties.

"There are hundreds of families who have tens of millions of dollars, and have 20 or 30 buildings, and a lot of them you've never heard of," said one source. "Some of them have less than 50 percent leverage. A lot of those families are going to hasten the pace at which they acquire now."

While some of these players have begun to do deals, many are still frustrated by prices they view as too high.

"I've done a deal or two, but not nearly as much as I would like," said Brooklyn landowner and developer Sandy Nager, who said he's purchased notes on small buildings for roughly 50 cents on the dollar.

For the most part, though, he said, "banks are still looking to obtain close to 70 cents on their mortgage dollar."

Institutional cash

Local operators don't have to rely on their own money for investment opportunities. Many are being backed by increasing amounts of institutional capital.

Among the most active players in this arena are AREA Property Partners, formerly known as Apollo Real Estate Advisors, and private equity real estate firm Angelo, Gordon & Co.

"Every asset that's out there, they're behind the scenes with a number of the players," said one source, referring to both firms.

AREA, a real estate investor and fund manager, was founded 15 years ago by William Mack and Leon Black. (The partners split in 2000.) AREA did not respond to requests for comment, but the New York Observer reported that it has a new distressed-assets fund as well as a "value-added" fund that's focusing on properties in need of repositioning.

Manhattan-based Angelo Gordon, meanwhile, weathered the downturn by "accelerating sales" of its real estate portfolio in 2006 and 2007, explained Keith Barket, the firm's

senior managing director.

"We didn't think cap rates would stay that low," Barket said. Today, the firm has about \$1.4 billion to invest after successfully raising a \$1.26 billion opportunity fund and another fund of \$800 million.

Two months ago, Angelo Gordon bought a portfolio of foreclosed residential land sites in Las Vegas and Phoenix and an office building in Washington, D.C. In addition, it's about to close on a Philadelphia office building, Barket said.

Why is the firm pulling the trigger while many investors are still on the sidelines?

First, not all of its funds are seeking opportunistic-level returns, and second, "we're not trying to call the bottom of the market," Barket said. "We're looking at property that we think is attractively priced and the owners

The firm does have some exposure. Earlier this year, 475 Fifth Avenue, which Westbrook owned with embattled developer Joseph Moinian, was returned to its lenders after the owners defaulted.

Westbrook "does have some bad deals, but they're in better shape than most," said one source.

Of course, not all these funds will be successful, especially in a difficult fund-raising environment. "A lot [of funds] have flopped," one source said.

The owner of Riverton Apartments in Harlem, Rockpoint Group, unable to find suitable investments, pulled the plug on a \$479 million debt fund after deploying only \$19 million of its equity, returning the money it raised to its investors, Real Estate Alert reported.

The surviving funds are relying more on

agreed to sell a 49.5 percent stake in its office building at 485 Lexington Avenue to a joint venture that includes the Israeli video company Optibase and Gilmor, a Nigerian engineering firm.

Mega-players

Additional funds are being collected by large REITs like Vornado, which announced in June that it's aiming to raise an additional \$1 billion for a private-equity fund to invest in distressed properties (see story on page 28).

SL Green, which owns 59 New York-area properties, has also said it's looking at deals here. And Leon Black, who recently formed Apollo Global Real Estate to take advantage of distressed opportunities, is preparing his first distressed fund and forming a \$600 million REIT to originate loans and take over bad debt, Private Equity Real Estate magazine reported in September.

One of the most active REITs in the market is Boston Properties, which focuses on large-scale office buildings in New York, Boston, Washington and San Francisco. Between 2005 and 2007, with cap rates decreasing and "valuation getting out of control," the company sold almost \$4.5 billion worth of real estate, Douglas Linde, president of Boston Properties, said at the Barclays conference.

In 2008, Boston Properties began buying again, purchasing the GM Building and three other Midtown assets from Macklowe's distressed portfolio for a record \$2.8 billion. "It was probably too early, but they are long-term assets," Linde said.

The company still has a substantial amount of unspent capital. "We are sitting on about \$800 million in cash," Linde added. "We do have plenty of capital to deploy when we start to see investment opportunities."

Perhaps the most active player in real estate now is Blackstone.

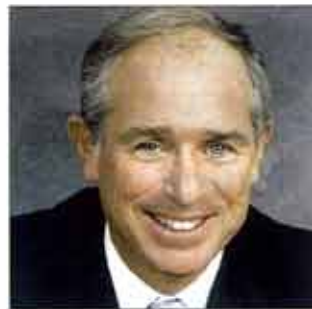
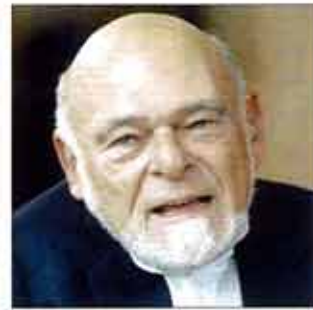
The private-equity behemoth sold \$60 billion of assets during the boom years, James said at the Barclays conference. Now, its real estate business "is pretty ideally positioned," he said. "We've got substantial dry powder to capitalize on current opportunities at much lower prices than we were looking at before, and much less in the way of competition."

Unlike many other companies, Blackstone has begun to dive in, though not yet in New York.

Last month, it announced plans to buy 148 properties from Sunwest, an operator of assisted-living homes, and purchased a 50 percent stake in the London office complex Broadgate.

"[After] waiting patiently on the sidelines since the fall of 2007, we're just beginning to see some attractive opportunities," James said, adding that the company would soon announce more new deals.

"You'll see us ratchet up the activity level in real estate," he said. **TD**



Top row from left: Bill Rudin, Douglas Durst, Leon Black; middle row from left: Marc Holliday, Richard LeFrak, Sam Zell; bottom row from left: Stephen Schwarzman, Stephen L. Green, William Mack.

are motivated to sell. You might miss an opportunity if you try to time the bottom."

Angelo Gordon, which has partnered with local companies like George Comfort and Young Woo & Associates, is searching for deals in New York.

"We have looked carefully at some of the transactions," he said. "We just haven't liked the deals we've seen."

For its part, the private-equity real estate firm Westbrook Partners — which has offices in London, Paris, Tokyo, San Francisco, Dallas and New York — has roughly \$3 billion of closed equity commitments ready to be deployed after closing the \$1.65 billion Westbrook Real Estate Fund 7 and the \$2.5 billion Westbrook Real Estate Fund 8.

About \$500 million of Fund 7 remains, but the bulk of Fund 8 has yet to be deployed, sources said.

foreign capital than in the past, since American pension funds have been less active, Fasulo said. "A lot of foreign investors have it in their mind that now is the bottom of the cycle," he said.

China Investment Corp. reportedly has held talks with U.S. private-equity fund managers, including BlackRock, Invesco, and Lone Star Funds, about investing in ownership interest in buildings and mortgage securities backed by commercial property.

Foreign investors are also looking to purchase New York assets directly.

In August, Young Woo and Kumho Investment Bank of Korea made headlines when they purchased AIG's two Lower Manhattan buildings for the rock-bottom price of about \$150 million. And prominent REIT SL Green, headed by chairman Stephen L. Green and CEO Marc Holliday, recently