Value-Add, NOI Growth the New Focus

By **Carrie Rossenfeld** | Orange County
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NEWPORT BEACH, CA-Real estate, once focused on buying properties that will quickly resell for a profit or buying them for the sake of amassing large portfolios, now has a new focus in order to be successful: NOI growth and adding value to assets. Speakers at yesterday's **ULI Orange County/Inland Empire** capital-markets event, "The Money Chase" described how the environment for acquisition and yield is changing.

"It's going to be all about revenue, not cap-rate compression, when buying properties going forward," said keynote speaker **Randy Anderson**, head of research for **CBRE**. "Growth is the most important portion. You don't want to buy when cap rates are high, but when NOI growth is possible."

Anderson added that capital is being raised for **value-add opportunities** and growth markets. "The environment's changed." He also predicted that **industrial** will be the top performer among the four food groups in commercial real estate this year, with **multifamily** being in a different phase of the cycle than the other sectors. "I'm a huge fan of multifamily, but the vacancy rate is starting to tick back up. However, the housing sector is underbuilt, so **construction** is coming back."

Retail is either dark or thriving, having taken hits from **e-commerce**, Anderson said. "Retail is a have or have-not business." Fielding a question from an attendee, he said that more capital is going to flow into the **suburban-office** sector, with several very large funds looking toward that asset class and small to medium-sized firms re-emerging to take up space despite the urban-office boom.

Speaking from many cycles of experience, panel moderator **Nelson Rising**, chairman and CEO of **Rising Realty Partners**, stated emphatically, "Today's interest rates are not high!" He advised attendees to heed hockey player **Wayne Gretzky's** motto: "Go where the puck is going to be," rather than merely following the pack or current trends.

When comparing today to a year ago, **Bryan Crane**, a principal with **Artemis Real Estate Partners**, said, “A year ago, we were buying notes, but by and large, that has been played out and those opportunities are fewer and farther between. We’re back to fundamentals and looking for ways to create value. The momentum in investing is largely done. We’re out of distressed and into value-add.”

However, **Pat Jackson**, CEO and founder of **Sabal Financial Group**, disagreed with Crane. He said that there are still more **distressed** properties to come online and more opportunities to acquire them.

Perceived threats going forward for the panelists include increasing regulation such as **Dodd Frank**, as well as too much capital chasing too few deals. Speakers said that mid- to upper-teen returns on investment for a five-year deal are considered a “good spot to be in,” and those looking for 20% or higher are not finding much in the market.

Morgan Lingle, executive director of **JPMorgan Global Real Assets**, said construction is strong where he is based in the Bay Area, partly because purchase prices have skyrocketed to the point where replacement costs are lower than buying existing inventory in some cases. “We’re surprised at how much product is being built right now, but we feel like it’s better to build at a discount to what they’re buying at at this point.”

At the end of the day, the experts said they seek value-add opportunities for true economic growth. “IRR is meaningless because what you plug in is the exit price,” said Jackson.

Most were in favor of **operating partners and joint ventures**, saying that finding strong companies to partner with close to the deal help make it successful. “About 95% of our investments are with joint-venture partners, and we believe this will be our key to success—identifying good, local partners,” said Crane.