TreppTalk™

Some REITs Are Selling, Who's Buying?

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Last week, we reported that a growing number of REITs are planning to sell their properties in an effort to capitalize on strong investor demand. So who's buying?

With risk-free rates at historic lows, investors of nearly all stripes are just salivating for any asset that could provide them with some sort of real return. Some investors are also looking to US real estate as a safe haven.

Brian Harris, Chief Executive Officer of Ladder Capital, a New York finance company, recently described some properties as being "safe-deposit boxes for foreigners." He specifically was referring to residential condominium units that often are purchased by wealthy individuals and families from politically unstable areas. But the description is appropriate for certain trophy properties that trade for prices resulting in miniscule capitalization rates.

Real Capital Analytics, meanwhile, pegs the average cap rate for real estate deals at 6.41% across all property types. That's probably a historic low (Real Capital's data goes back only to 2001), but still represents a hefty 405-basis-point premium over the risk-free rate of return. Of course, trophy properties in major markets garner the biggest headlines (and the lowest cap rates), but few of the REITs that have indicated they'd be sellers have many of those types of properties in stock. Instead, they're hoping that investors will look to the properties they plan to sell in order to generate better-than-average returns.

First Potomac Realty Trust, which is one of the REITs that's in the sales market with some $200 million of properties, probably won't get too much interest from the likes of the Government of Singapore, China's Anbag Insurance Group, or Norges Bank Investment Management. Each of those entities is among the biggest buyers of US commercial real estate so far this year. Instead, First Potomac's aiming at investors who might be attracted to properties that could be had for prices resulting in cap rates of perhaps 7% or more.

That's in contrast to the 4.04% cap rate that was pegged to Norges' $1.8 billion acquisition late last year of a 45% stake in a portfolio of office and retail properties in Boston and New York from Boston Properties. Some New York properties have traded at sub-4% cap rates. Naturally, properties that sell for prices resulting in higher cap rates tend to be riskier than those that trade for lower cap rates, all other things being equal. But many investors are comfortable being able to quantify and deal with that risk.

Think of investors like True North Management, a White Plains, New York investment manager that raised $548 million for a fund earlier this year. Among other things, it will invest in properties that might have occupancy or other issues. HFZ Capital Group of New York recently plunked down $12.2 million to buy a pair of massive, but nearly empty, office buildings in Detroit (pictured right). It's aiming to redevelop the properties into a mix of office, retail and residential space.

Finally, **Advalurem Group** of New York is regularly picking up small to mid-sized properties in what largely are secondary markets. Those types of investors keep the commercial real estate markets humming, yet none would appear on any list of top buyers. These firms are typically investing relatively small chunks of capital in smaller properties than do the big buyers.