Cap rates seeing 'a little bit of stabilization,' Hanover Real Estate partner says
By Tom Yeatts
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Hanover Real Estate Partners recently sold a 270,000-square-foot office building in Rosemead, Calif., to Southern California Edison Co. for $33.8 million. On March 12, SNL spoke with Hanover Managing Partners Ken Boyle and Reed Miller about the transaction.

The building, located at 1515 Walnut Grove Ave. in close proximity to Southern California Edison's corporate headquarters, was originally purchased in a sale-leaseback transaction by Potters Avenue LP in 1983 and was leased under a long-term net lease to Citibank through Oct. 31, 2008. Citibank, in turn, had subleased the entire building to Countrywide for its mortgage call center operation.

Hanover, a privately held real estate investment company headquartered in Greenwich, Conn., was brought in as the managing general partner of Potters Avenue to oversee and transition the building through the lease expiration and resulting vacancy. A significant part of Hanover's investment strategy is to acquire properties or joint venture with existing owners to transition and reposition real estate properties in the midst of challenging economic conditions, the company said in the news release about the transaction.

Miller told SNL that Hanover initially sought to lease up the building and spent roughly two years looking for a tenant. In discussions with Southern California Edison, however, it became clear that it would be more advantageous for all parties for Southern California Edison to acquire the asset.

"In 2009, it was difficult to acquire assets," Boyle said. "Because regardless what you purchased, six months later it was probably — even if your underwriting was exactly right on target — six months later the building was probably worth less than what you purchased just because of an increase in cap rates." Boyle noted that while everyone expected capitalization rates were going to get worse in 2009, the rapidity of the deterioration was largely unexpected.

Boyle said, however, that he is beginning to see "a little bit of a stabilization" of cap rates. Cap rates on stabilized properties with good rent rolls and quality tenants are in the 7.5% to 8% range, while "anything short of that" is registering in excess of 10%, he said. "That's the new model that sellers are starting to get used to, but I think that will help," Boyle said. "Banks still have very conservative underwriting practices, depending on what market they're in. But at least deals can happen, because you're not expecting the overall capital markets to change as drastically anymore."

Boyle noted that one still has to be "very conservative" with underwriting and lease-up projections. "Rental rates are still declining or staying relatively low. So you still have very conservative underwriting," he said, "but at least from a capital markets perspective, and from a macro perspective you're seeing a little bit more stabilization. So it makes deals a little bit easier to happen."