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December 2015 · Volume 13, Issue 4

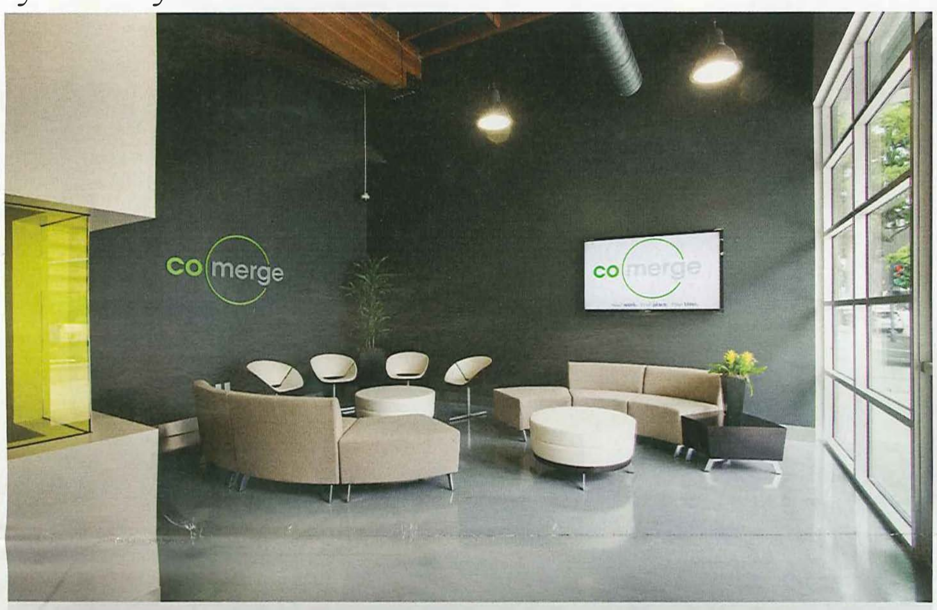
WESTERN REAL ESTATE BUSINESS®

Connecting Real Estate in the West

THE CO-WORKING TREND TAKES OFF IN THE WEST

An unconventional type of company is snatching up office spaces in some of the West's burgeoning downtowns.

By Nellie Day



As someone who worked from home, Kenny opened Co-Merge in Downtown San Diego in 2011 to provide this community with the same resources offered to Fortune 500 in-office employees.

What do you call a co-worker who has no co-workers? A freelancer, or solopreneur. What do you call a company owner who has few employees, but lots of co-workers? If you're in the office space game, you'd call them the next savvy real estate investors.

The latest technologies have allowed employees to remain connected 24/7. Pair that with a general downsizing in office space by many companies, and you have the recipe for many Millennials' dream job: one with ample freedom, that can be accomplished on their own schedule thanks to mobile technologies. While working from home in one's pajamas is wonderful, many telecommuters can find that being home all day sometimes breeds less than desirable habits. Namely, sitting around in one's pajamas all day.

Thus, a new type of office space has formed. Co-working spaces offer professionals the same office environment and sense of accomplishment many traditional office settings provide, but also give them the freedom to come and go as they please without a boss looking over their shoulders. Though the trend is currently in its infancy, about 40 percent of the workforce will be composed of freelancers, temps, independent contractors and solopreneurs by 2020, according to a study produced by Officevibe, an employee engagement software company.

Cornering the Urban Cores

Many co-working companies are scouting sites in the most bustling

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INDUSTRIAL OPPORTUNITIES

Two *WREB* experts believe the West's industrial sector points to the next big value play.

BKM recently acquired the 225,435 square-foot Koll Cotton Center in Phoenix. The firm plans to use its operator model to turn the asset around and lease up the available space, resulting in strong profits upon stabilization.

THE NEXT INSTITUTIONAL ASSET CLASS

The West's multi-tenant industrial market is poised for recovery, presenting a great opportunity for savvy investors.

By Brian Malliet, CEO and Co-Founder, BKM Capital Partners

Multi-tenant industrial might not be the sexiest product type out there, but it is the next important institutional asset class, as these properties present tremendously lucrative opportunities for yields over the next two to three years.

We will see increasing institutional interest in multi-tenant industrial assets as 2016 approaches that will be based on three primary factors, outlined below:

1. Timing

Multi-tenant industrial has lagged behind the rest of the industrial sector. This is extremely good news for investors.

While big box industrial product bottomed out years ago and has now made more than a full recovery, rents in multi-tenant industrial didn't hit bottom until about

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a year and a half ago. Since then, we've seen occupancy rise and rents increase. This translates into a tremendous opportunity to deliver yields.

Malliet

BKM is sourcing and buying multi-tenant industrial assets that are 50 percent below peak pricing. These assets are also about 50 percent below replacement cost. From there, the firm utilizes its operator model to turn the asset around, stabilize it and achieve strong profit from stabilization.

This opportunistic, or value-add, play is meant to take advantage of a lagging market. In this scenario, the firm can recognize the opportunity to come in and restructure the capital stack with proper capital to perform the execution, something any institutional-quality product operator understands.

2. Returns and Cash Flow

Multi-tenant industrial is much more attractive than big box industrial for institutional investors in the current market.

Large credit tenants sign seven- to 10-year leases in big box spaces, making this investment type similar to buying a bond. If a big box asset has a 10-year, locked-in income stream with a very high-credit tenant, pricing for that asset becomes extremely aggressive.

In contrast, multi-tenant industrial rents roll every one to three years, providing a much faster opportunity for increased cash flow.

Coming out of the recession, BKM sought an industrial product type that could deliver 20-plus levered IRRs (internal rate of return) and double-digit cash-on-cash returns. Multi-tenant industrial emerged as the product type of choice for this objective.

Essentially, when we buy an asset at today's pricing, we lease it at today's rents. The majority of our profit is broken down into a 50-50 ratio, where half comes from cash flow once we stabilize, and the other half comes from fixing the asset with capital improvements and essentially taking the asset from a C-level rent to an A-level rent.

The returns are there if you can do it.

One caveat that is important to note is that anyone investing in this product type needs to have, or be working with someone who has, an operator platform. The strategy outlined above must be executed in a specific way, within a certain timeframe. With this in mind, an investor must have hands-on construction management,

BKM acquired the 223,009-square-foot Patrick Commerce Center in Las Vegas in the last quarter of 2014. Malliet believes multi-tenant industrial product will be a great opportunity for institutional investment over the next two to three years.

asset management and property management all in one place to succeed. Having people on the ground at each asset who can execute is a key to making this strategy work.

3. Current Ownership

The multi-tenant industrial market is exactly where student housing and self-storage were a decade ago: poised for institutionalization. Much of this is based on ownership.

There is a bifurcation of owners within the multi-tenant industrial product type. Some are institutional owners that are just beginning to get into this space. The majority, though, are mom-and-pop or high-net-worth owners who have invested in these properties simply because they are located in a market where the investor has lived and done business, not because they know real estate.

The mini storage and student housing spaces were the same 10 years ago - most of these assets were owned by local, small operators spread throughout the U.S.

At that time, a few major mini-storage institutions came in, built their execution team, put processes and procedures in place, and ultimately institutionalized the asset class from an execution standpoint and from an ownership standpoint.

The same thing has happened more recently in the student housing space. Three major institutional-size student housing operators have revolutionized this segment of the industry in terms of bringing processes, procedures and professional execution into it in just the past five to seven years.

Multi-tenant industrial will be next, and we'll see this institutionalization occur in 2016 and beyond.

Looking ahead, multi-tenant industrial product will be a huge opportunity for institutional investment over the next two to three years until pricing in this sector catches up.

Once that occurs, BKM will likely move to a core or core-plus fund focus. That said, after acquiring multi-tenant assets, putting a good operator model in place — which includes proven policies and procedures and deployment of appropriate capital — BKM believes it can still achieve 8 percent to 10 percent cash-on-cash returns. That is a very attractive cash-on-cash return today, and it will continue to be attractive even after the entry of institutional capital — which in turn will drive down overall returns.