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Market for Silicon Valley commercial real estate remains healthy

By Katherine Conrad
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Analysts tracking commercial real estate investments across the country have declared that "the party is over," yet Silicon Valley is still ordering champagne.

The reason?

The valley's underlying fundamentals - job growth, falling vacancy rates, rising rents and little competition from new office construction - have kept the region squarely in investors' sights.

Erik Doyle, who handles investments for CB Richard Ellis, and brokered the valley's record-breaking $1.1 billion Peery/Arrillaga portfolio sale in 2006, said he's on track to close 28 deals by the year's end, compared to 16 in 2006.

"We're coming out with eight to 10 new deals in the next 30 to 45 days," he said. "Our team is going to surpass 2006 volume even with the Peery/Arrillaga sale."

Granted, the easy money of the past several years is gone; the credit crisis triggered by the meltdown in the residential subprime market ensured that tighter lending standards are in place for all loans. And whether 2007 will surpass 2006 - when $5.6 billion worth of commercial real estate traded hands in the valley - remains to be seen. (The Peery/Arrillaga portfolio raised the bar pretty high.)

But analysts and industry experts alike remain bullish about the South Bay.

"Generally speaking, your economy is far more robust than Orange County, San Diego or downtown L.A.," said Bill Halford, president of Irvine-based Bixby Land Co., and former head of the Irvine Company, a renowned development company that built Irvine. Since Bixby Land entered the valley market a year ago, it has bought three office parks and is negotiating to buy a fourth.

"Silicon Valley is unique in that there continues to be very strong rent growth and tenant demand far in excess of what we see in other markets," Halford said.

Before the credit crisis reared its head this summer, 2007 was on its way to another investment record for the entire country. During the first half of the year, $131 billion worth of office property changed hands in the United States compared to $136 billion that sold in all of 2006, according to New York-based RealCapital Analytics.

Not surprisingly, the sales activity drove up the price per square foot as well. The national average so far this year was $230 per square foot, but both the San Jose and San Francisco markets reached higher, with $287 and $339 a square foot respectively. And one park went even higher: a Sunnyvale office park built in 2001 recently sold for $530 a square foot, or $226 million.

But not every deal has gone so swimmingly. Just ask Carl Berg, head of Mission West Properties. Berg watched his deal to sell a 6.9 million-square-foot portfolio for $1.8 billion collapse in August - just as the subprime crisis hit its height - when the lender pulled its funding out of the huge deal.

"This subprime (problem) has affected the market tremendously," Berg said, noting that he is negotiating with new buyers who aren't as dependent on bank financing.

"If they come through, we've got a deal. If they don't, we'll take if off the market in early October."

Such examples have led Nassim Hadji, national research director for Walnut Creek-based Marcus & Millichap, to predict that deals nationwide could be off by as much as 40 percent.

"A lot of deals will get delayed. Some will be repriced and others will fall apart."

But, he added: "Nothing has changed to take the status of commercial real estate from very healthy to anything other than that. Vacancy and rents show a healthy level of growth into 2008."

Dan Fasulo, RealCapital's managing director in New York, said there is still "a tremendous amount of surplus capital looking for a home in commercial real estate" - and most of those investors have their eye on the valley.

"There is no question that Silicon Valley is on investors' radar as an attractive place to put money. That has not changed one bit, nor do I expect it to," he said. "The fundamental story is fantastic in the Bay Area."

Bixby's Halford likes the region so much he approached the owner of Santa Clara's Airport Technology Park last spring seeking to buy the 20-plus-year-old office property - even though it wasn't for sale.

By late summer, as markets were roiling, Halford beat out other offers for the property that finally hit the market, and closed on the $85 million deal. It doesn't hurt that the century-old company is an all-cash buyer.

"It's a big advantage, especially in this environment," said Halford, who plans to buy more - provided the buildings are located in Silicon Valley. It's all about tech.

"Cisco, Yahoo, Google, they're all growing," Doyle said. "We're being less impacted in the valley due to our strong fundamentals. And the fundamentals over the next quarter to a quarter and half will get even stronger."

Or as Fasulo put it: "The reason prices are falling on the residential side is there are too many houses. We do not have that problem on the commercial side."