

**High-Tech Relocation:
A Substantial Near-Term Opportunity**

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Over the next few months, significant opportunities will arise for investors and redevelopers to acquire and reposition office and R & D buildings formerly occupied by single-user technology and telecom tenants. Many of these opportunities will surface in recently hard hit markets such as Silicon Valley, Seattle, Austin, Denver/Boulder and Portland.

Private, non-traditional real estate lenders will lead the way in funding the turnaround capital with short-term acquisition and re-development capital due to the ongoing reluctance of traditional lenders to take on these turnaround plays. Traditional lenders have taken a backseat in underwriting these investments, reducing LTC/LTV advance rates, and requiring higher debt service coverage ratios and higher operating reserves.

The non-traditional lenders financing these opportunities must pay special attention to the borrower's projected costs to convert buildings designed for single-users into buildings capable of accommodating several tenants.

The conversion cost projections have to consider the following: Demising walls and fire corridor installation; adequacy of restroom core locations; utility of in-place power consumption monitoring systems; sufficiency of existing building amenities; and lobby design and layout, among others.

Demising Large Floor Plates

Frequently, high-tech companies designed and occupied buildings with large floor plates featuring large open spaces accommodating numerous cubicles and workstations, with limited hard-walled offices. These floor plans feature numerous conference and team rooms and a limited number of perimeter private offices.

Many of the repositioning borrowers will adopt a strategy of converting the large floors (many are 30,000 SF – 40,000 SF) to accommodate multi-tenancy, filling the building as quickly as possible with smaller and mid-size tenants.

This conversion strategy can become tricky and expensive without extensive pre-planning. Interior corridors have to be designed and constructed to provide secure and code-conforming means of ingress/egress for individual tenants. In addition, significant costs will likely be incurred to demise each tenant's space to meet their specific demands. In many of the target markets, in order to attract new tenants, the landlord will have to fund a significant amount of the cost relating to the installation of tenant improvements, which can range as high as \$40 per square foot.

By way of further example, fire corridors have to be constructed off elevator cores given the new multi-tenant nature of the building. These costs vary from building to building, and from region to region. However, the point remains that these costs exist and success in redevelopment requires careful analysis and cost estimation.

The assessment of in-place monitoring systems for power consumption in single-user buildings presents another similar challenge. Most often, the existing systems are simply not designed to handle multi-tenant occupancy. In other words, each tenant will demand that it pay only for the power it consumes and in a multi-tenant building, each tenant's consumption of power can differ considerably.

For example, the power consumption of a law firm differs greatly from that of a start-up technology company that may have several server rooms within its premises, all requiring 24/7 cooling and an "always on" supply of power. The cost of converting in-place monitoring systems to handle the needs of several tenants can be substantial and typically involve the installation of sub-panels on each floor ensuring an effective monitoring and cost allocation of consumption.

Building Amenities

In order to quickly re-lease the subject properties, the redeveloper has to be prepared to provide building amenity packages that are consistent with or superior to what is common in the market. Often, high tech companies either did not provide for

such amenities or provided the amenities in a nearby, but separate building. New facilities often include cafeterias, exercise facilities and daycare centers – all are expensive to install and operate. The borrower is also likely to lose rentable square footage, negatively impacting the potential income stream.

Relocating Restrooms

The location, orientation and configuration of existing restroom areas has to be carefully considered. Effective integration of these facilities into the interior corridor layout is critical. If such an integration is impossible, then the developer has to take on a costly and complicated relocation involving extensive demolition, plumbing redesign and approval.

The Lobby: Creating a Corporate Image

As in the case of building amenities, it is common for technology or telecom companies occupying several buildings within a business park to substantially improve just one lobby in just one building. This one “over-improved” lobby approach helped portray a certain corporate image. This single lobby is likely to satisfy the demands and expectations of multiple tenants in the “lobbied” building. However, the “secondary lobbies” in the other buildings most likely will require substantial upgrades to compete within the market and attract new tenants. Typically, these secondary lobbies featured a significantly scaled back design and lobby upgrades may require the installation of new floor and wall coverings, artwork, more abundant primary and accent lighting and signage. Unfortunately, these additions can be very expensive.

While it is often difficult for the borrower to estimate “hard” numbers for these costs prior to the close of escrow (as many of these acquisitions will have to close in short order), lenders have to understand the estimation process. The early involvement of a qualified architect and contractor is critical in developing a realistic conversion budget and should result in fewer future surprises.

Soft Costs: The Hidden Component

The redeveloper and lender also must pay special attention to the “soft cost” component of the budget – a task often more daunting than that required with the hard

cost analysis. While municipalities and counties are often anxious to support new tenancy in vacant properties, it often takes considerably longer to gain approvals than most redevelopers are willing to admit when they are budgeting.

By nature, redevelopers also tend to underestimate the re-leasing challenges they face. Finding new tenants can prove highly challenging, even with a great new design. In addition, the cost of carrying a vacant property can quickly erode or evaporate an initially attractive margin and wipe out the benefit of a below replacement cost purchase. Financing costs and taxes can add to the burden.

Conclusion

Successful redevelopment of single tenant, high tech properties into multi-tenanted buildings requires a careful consideration of a wide variety of cost and planning issues. However, approached with the rigor typically required of new development, these opportunities can produce highly attractive returns. Anticipating all the challenges and effectuating the plan on a timely basis are critical to the ultimate success of the repositioning.

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