THE REAL DEAL ONLINE

Will Sam Zell's confidence be contagious?

Mogul's recent NYC buys create much-needed jolt -- and there may be more in the works
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By Adam Piore

It's hard to find a real estate figure with a better reputation for timing the markets than Sam Zell. The blunt, motorcycle-riding, Chicago-based mogul is known for snapping up distressed assets when prices hit bottom.

No surprise, then, that a spate of unexpected, high-profile deals involving the Zell-chaired REIT, Equity Residential, is generating a growing sense of elation among local real estate players desperate for signs of a recovery.

"Does it get any better than when Sam Zell starts buying property in your market?" said Dan Fasulo, managing director at Real Capital Analytics. "I don't know how much more confidence investors need to start making decisions. Everybody has got to realize that the world is not over."

Zell's very publicized New York City buying spree began in January, when Equity Residential reportedly shelled out about $12 million for a distressed lot on the corner of 10th Avenue and West 23rd Street owned by developer Shaya Boymelgreen.

It was the company's first deal in the city in more than three years. Equity Residential discussed the buy during an earnings call last month, disclosing that it plans 111 market-rate apartments and about 10,000 square feet of retail space on the site.

The company made its first New York City purchase in mid-2004, and now owns 26 properties with 7,320 units, according to one estimate in the Wall Street Journal.

However, it was Zell's recent deal to purchase Harry Macklowe's last three Manhattan apartment buildings -- the 323-unit River Tower at 420 East 54th Street, along with Longacre House at 305 West 50th Street and 777 Sixth Avenue, each with 293 units -- for $475 million that has really gotten attention.

Taken together, the two transactions would appear to be an aggressive bet on New York's residential market. (Zell has not waded into the commercial market here in recent months.)

Haendel St. Juste, an analyst with Manhattan-based Keefe Bruyette & Woods, called the deal "by far the most significant transaction done over the last year."

"A few others have been dabbling, but this is different," he said.

Ironically, Zell is picking up the pieces of a Macklowe empire he may have inadvertently helped topple. In 2007, Zell sold his portfolio of commercial properties to the Blackstone Group, which flipped seven of the portfolio's New York buildings to Macklowe. Macklowe defaulted on part of that debt in 2008, causing a cascade of sales throughout his empire, including the three residential buildings in the current deal.

Both Equity Residential and Macklowe Properties declined to comment.

However, Equity Residential CEO David Neithercut has publicly suggested there may be more purchases to come.

"We had refrained from buying any assets for quite some time, really from just trying to be defensive, worrying about the balance sheet, worrying about the credit meltdown and our ability to fund ourselves going forward," he said during an interview with Bloomberg TV early last month.

"We continued to sell assets for several years and hoard cash, pay down debt and make sure we had sufficient capital to pay off our debts in 2010, 2011. And when the credit markets improved and we became more comfortable in our ability to fund ourselves on an ongoing basis, we began to think more about acquisitions."

Equity Residential and Macklowe held "preliminary discussions" about the three rental buildings earlier in 2009, "but interest died, I think on the seller's part," Neithercut said. In early December, Billy Macklowe called Zell "trying to get things started again," Neithercut said. "We were happy to get that call and proceeded very quickly to try and make a deal happen."

Most observers estimate Equity Residential acquired the properties at an average cost of $500 to $550 per square foot, well below replacement costs of about $800-plus per square foot. One veteran industry source described the price as "exceedingly low," noting that the apartments are all market rate and would have been sold at between $800 and $1,000 a square foot at the market peak, assuming they would have been converted to condos.

At $475 million, the price tag amounts to a 50 percent discount off the peak prices that Macklowe had paid, according to the Wall Street Journal.

"This was just one of those deals that, you know, happens every now and then and one can't, you know, can't dally," Neithercut acknowledged on Bloomberg. "One has to get right on it, and so we did."

Analysts say the buy fits in perfectly with the company's overall business strategy -- as do two purchases it made this year in the Washington, D.C., area. (Separately, Zell stepped down as CEO of the bankrupt Tribune Co. in December, but will remain chairman.)

In recent years, Equity Residential has increased its allocation to higher return/higher barrier coastal markets such as Los Angeles, Boston, Washington, D.C., and Seattle, while exiting lower-growth markets in the middle of the country, St. Juste said.

"We believe we can continue to sell assets as we exit older assets in our non-core markets, and that will create the capital that will enable us to invest in our core markets," Neithercut said. "And I do expect to see more opportunities to buy assets in 2010 than there were in 2009."

Still, experts are divided on what Zell's buys will mean for the market.

St. Juste said they "certainly help to establish the value for current assets on the market."

Like Real Capital's Fasulo, Barry Hersh, a clinical associate professor at the Schack Institute of Real Estate at New York University, said industry players will likely regard Zell's moves as an indication the market may be approaching its bottom.

"Sam Zell is as good a picker of distressed real estate as there has been," Hersh said. "I would never bet against him.

"I take it as a sign that he thinks it's bottoming, and that the New York market in general, and his properties in particular, were a bargain," Hersh said.

But others point out that the deal for the three Macklowe buildings was a unique opportunity in a unique segment of the market.

Bob Knakal, chairman of Massey Knakal, said the deal may establish a price point for similar buildings -- those at a similar price level with no rent-regulated tenants. He said, "It's another data point, and with the market the way it is, every data point is very helpful."

However, he continued: "I don't think it's indicative in value for rent-regulated properties, and it is not indicative of value for smaller units. Such a large slug of equity was needed; it limited the pool of potential buyers that could afford to buy them." As for the rest of the market, he added, "I think that prices are continuing to slide."

Fasulo noted that "it's going to be several years until we see a full recovery in rents and occupancy markets." But he added: "I think it's fair to say that the mass layoffs are over; that we are starting to see some spot hiring, which at the end of the day does bode well for the rental market."

A full recovery, he said, "is going to get priced into the market much faster than many believe."