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Office condos swing from popular to a problem investment

By Marilyn Bowden

Office condos, a popular product at the height of the boom, aren't in much demand now, and many have reverted to leasing unsold space. In most cases, real estate attorneys say, they will probably remain hybrids for the foreseeable future.

"It's very similar to the situation we find with residential condos," said Margaret "Peggy" Rolando, a partner at Shutts & Bowen.

"The developer may still be in control, but there are issues with maintenance and quality of services. Or there may be a situation where the construction lender is foreclosing on unsold inventory, and depending on what the exit strategy may be, will be offering it for sale or for lease."

In general, she said, lenders are trying to dispose of the collateral once they recover it.

Becoming a landlord was not in the game plan of either the lender or the developer when the property was built, said William P. McCaughan, a partner at K&L Gates, "so they will end up selling it to someone who will be renting out units until the market improves and they can sell them."

Until that time, he said, the only solution, if it were practical, would be to dissolve the condominium – and that would require the consent of every owner, an unlikely scenario.

"You'd have to get everybody on board for termination of condominium," said Manny Farach, of counsel with the law firm of Richman Greer. "So there is no



Photo by Maxine Usdan

"For an investor willing to buy this type of property, the typical strategy is to lease and then sell when the market stabilizes," explained Margaret "Peggy" Rolando, a partner in the Shutts & Bowen law firm.

easy way to get around the issue.

"What ends up happening a lot of times is that folks will eventually start selling because they don't like bulk buyers taking over the board. A bulk purchaser could start making life difficult for the individual owners."

While office condos have long been successful in the medical field, for many office users they're just not a practical choice.

"Office condos are restrictive," Mr. McCaughan said. For example, an accounting firm that buys 10,000 square feet will have no flexibility if later the company needs less or more space.

"Before buying a condo, they have to be pretty sure of what they are doing," he said. "So why choose to buy rather than rent? There's usually only one reason – they anticipate that the value of that asset is going to increase.

"There might be tax reasons, but

in this market, with this economic situation, buying office space is probably the last thing anybody is going to do. Is anybody going to buy in right now to a condo where other people aren't paying their assessments, so some amenities aren't being maintained?

"So somebody who owns a condo right now or a lender about to own one is going to have to start leasing out office space."

One difficulty with renting out unsold office condo space, Ms. Rolando said, is that typically it has not been built out. "So there is some substantial expense involved before a developer, lender or new owner can lease it. They're not going to get tenants very easily if they don't have the money for the tenant improvement work.

"Especially in smaller suburban-type office condos, they aren't likely to have the money upfront for that."

A lender leasing unsold space, she said, is not going to want to get involved in long-term leases because they're intending to sell the space to a bulk purchaser, and that makes the tenant-improvement outlay that much more expensive.

Bulk owners usually also just want out, Ms. Rolando said.

“For an investor willing to buy this type of property, the typical strategy is to lease and then sell when the market stabilizes.”

But once that space is foreclosed or resold, she said, “it can be a good thing in that the property is stabilized. It establishes a floor on prices.

“Other owners will recognize they paid a lot more than the new owners, but at least there is someone now who is invested in the property and interested in stabilizing it. It's not as if they're getting in not knowing what it will cost to maintain it and pay their assessments.”

