

Sees Strong Rental Market

Testa is shifting his business strategy from trading REOs to building a portfolio of rentals.

He said this year he had a fund approved with the state's Department of Corporations to raise \$100 million in \$25 million increments. The fund will have a first right of refusal to buy and lease these renovated homes or it can buy and sell REO portfolios or do short-term bridge loans.

"Owners are being displaced by losing their homes. But they want to stay in Orange County. Gen Ys are splitting up and getting jobs. There's so much demand that we're getting four or five full-price offers within a week on every rental we've put on the market in the last six months. It's a very strong rental market."

"I think we're at the bottom and are bouncing along the bottom right now. The rental market anomaly we're in is pushing up rents during the holding period. The exit strategy in five to seven years will be driven by the Gen Y buyers, 81 million of them."

Voit Reports OC's Industrial Rates On Track For First Increase In More Than Three Years

Orange County's asking industrial lease rates ticked up since the end of the second quarter and are on track to post the first quarterly increase in more than three years, says a mid-quarter report from Voit Real Estate Services.

Voit also said the Inland Empire's industrial lease rates increased for the first time since the fourth quarter of 2007.

"The steady improvement in lease rates is a good indicator that industrial property values may be on their way up throughout Southern California," said Jerry Holdner, Voit's director of market research. "While 2010 proved to be a stabilizing year, most market support indicators have turned positive in 2011, and these recent upticks in industrial lease rates are a clear example of that improvement."

Voit reports an improvement in industrial lease rates in Los Angeles County in the first eight weeks of this quarter, with the average asking triple-net lease rate rising one cent since the second quarter and two cents since the first quarter to 55 cents in the mid-third quarter.

Asking Rents Up A Penny

The Orange County industrial market has also demonstrated improvement in the beginning of 2011's third quarter, with the average asking triple-net lease ticking up one penny from the first and second quarter of 2011 to 53 cents per month per square foot.

During the beginning of the third quarter, the Inland Empire monthly industrial lease rate rose one penny to 35 cents per square foot.

"On a combined basis, Southern California's overall average asking triple-net lease jumped up a penny from the first quarter to the second quarter this year, and has held steady at the current rate of 49 cents per month per square foot," said Holdner. "The widespread increase in rates year-to-date, coupled with rising industrial lease rates in three major markets just eight weeks into the third quarter, indicate that the industry is coming off the bottom."

Battleship USS Iowa Headed To SoCal For Display; Big Plans For 'The Big Stick'

As impressive as the collections of great bygone war-planes are hereabouts – from Gen. William Lyon's museum at John Wayne Airport to the Planes of Fame at Chino – the region is soon to welcome some big guns: The battleship USS Iowa, aka "The Big Stick," is being ticketed to San Pedro for permanent display.

Navy officials announced this month that San Pedro's bid beat out efforts to anchor the mighty Iowa in Vallejo, north of San Francisco. Some \$9 million has been secured for the Iowa's restoration when it arrives, which could be as soon as next summer.

Years of lobbying chiefly by Robert Kent of the Pacific Battleship Center in San Pedro succeeded in persuading the Navy to reopen competition for the Iowa, the last of the United States battleships and the only one of her class to serve in the Atlantic during WWII.

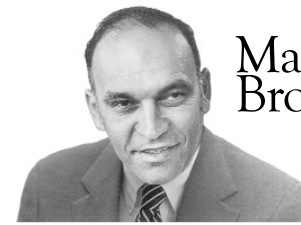
Big Tourist Draw

Decommissioned in 1990, the Iowa carried FDR to Casablanca for the first leg of his meeting in Tehran with Churchill and Stalin. In the Pacific in 1944, it shelled Marshall Island beachheads and was on hand in Tokyo Bay for the Japanese surrender. Later it was involved in raids on the North Korean coast.

For its restoration, Kent raised \$1 million and secured a commitment from a bank for \$5 million. The state of Iowa kicked in \$3 million.

Based on the tourism success of the aircraft carrier Midway in San Diego, the Iowa's organizers estimate the Iowa will attract 450,000 visitors annually and will create 100 jobs and generate \$250 million over 10 years.

It's fitting that the Iowa will tie up in San Pedro. Nearby Long Beach used to be called Little Iowa for all the hawkeyes migrating west and settling there before the war.



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Thornberg: No 'Double-Dip' But Says Taxes Need Raising; Favors National Health Care

Chris Thornberg, the real estate economist and forecaster known famously for calling the bubble and collapse, delivered some sharp broadsides at several large and controversial targets, namely the tea party and national health care and tax policies, when he spoke recently at a real estate conference in Orange County.

Appearing with UCI's Kerry Vandell on a panel in front of about 500 attendees at the Balboa Bay Club, Thornberg said he believed the economy and real estate markets still are on the long and bumpy road to recovery and that a double-dip recession will not occur.

"Markets will stabilize. The second half is going to be good. We're still overspending. We need to start paying more taxes. The fundamentals are still OK. It's going to take a while to get there," he said.

But during the session, which was part of RealShare Orange County 2011, Thornberg took dead aim at a number of subjects not normally included in his presentations on the outlook for real estate and the economy.

Tax Policy Misdirected

On taxes, he said, Americans need to pay more. The U.S. tax rate as a percentage of gross domestic product in 2008-09 averaged 34%, the sixth lowest among 33 developed nations and ahead of Japan, Turkey, Korea, Mexico and Chile. He noted that the average among nations in the EU is 45%.

Thornberg took his criticism of tax policy a step farther, saying it exacerbates the nation's already lopsided trade imbalance. Tax cuts and low taxes enable con-

sumers to spend more but argued that much of that spending is on imports.

"Our tax cuts are stimulating China," he said.

He said the U.S. "under-invests in education and infrastructure and has failed to rein in the high cost of medical care."

"The U.S. spends more on medical care per person than any country yet life expectancy is shorter than in most other developed nations."

A number of reports support Thornberg's claim. An analysis by The Commonwealth Fund shows that the U.S. spent 17% of its GDP on health care, the highest among developed countries. The Congressional Budget Office estimates the rate will rise to 25% by 2025 without changes to federal law.

U.S. Tops Health Care Costs

The Organization for Economic Cooperation and Development reports that in 2008 the United States spent \$7,538 per person. Norway was second at \$5,003. The U.S. spends two and a half times more than the OECD average of industrialized countries and joins Turkey and Mexico as the only OECD countries without universal health coverage.

Vandell joined Thornberg in the view that the recovery would be long and uneven. Both men were critical of the political bitterness gripping Washington, D.C., which some attributed to the recent downgrade of the nation's credit rating.

Thornberg went so far to question the fundamentals of the tea party, saying its followers are "people I do not understand in any way, shape or form."

Vandell said the political divide is a threat to the economy and that tax increases were needed.

"Single most damaging is the political risk that affects decision-making. The situation in Washington is ugly," Vandell said.

No Double-Dip Seen

He joked that the anti-government rhetoric leads him to believe "we're the most taxed nation in the world."

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Alternatively, he said he believed “the Fed has been doing as good a job as can be done.”

Both men said their belief in the continued recovery is based on an absence of economic imbalance. “Recessions don’t come out of the blue,” he said. Recessions come from “large, rapid and sustained financial imbalances.”

“Without a doubt, we’ve seen hits to the financial markets. But where are the imbalances? Housing is at bottom and will stay flat, consumers have taken a hit but labor markets are in a slow recovery mode.”

As the two men spoke, the world’s financial markets were undergoing their biggest spasms since 2008, brought on by shaky sovereign debt in Europe.

Thornberg said the reason for the huge swings in values are because financial markets “expected a faster recovery. This is a necessary correction.”

Thornberg said later the mostly likely solution will be that Europeans will set up a TARP-like bank bailout.

“The EU may break up but that’s years down the road. Otherwise the EU’s not that big of a problem,” he said.

After Hard ‘Landing,’ Land Interests’ Founder Looks Ahead With A Gimlet Eye

What does it tell us about the real estate scene when one of the hottest new companies in OC goes by perhaps the most generic of all possible names? Land Interests Inc. – it kinda says it all.

Land Interests is a home-grown asset management company with a staff of 30 that includes experts in real estate, law, accounting and finance. Its founder and CEO is Erik Frechette, who may be proof that surviving a parachute accident can focus the mind.

“I hate to sound like a cynic but I think the fundamentals are still messed up.” Frechette tells OC Report. He says he’s often guided by an inner skepticism and somewhat contrarian nature in analyzing the way forward. “If someone tells me it’s raining, I have to see for myself. This is going to take a long time to unwind.”

As for the company name, he self-deprecatingly says he “wasn’t creative enough” to come up with something better, which could be true. But it is an awesome name: bold, confident and sweeping.

After a skydiving mishap that was serious enough to cut short his Marine Corps aviation career at 12 years, Frechette moved to Southern California and completed grad school. In January 2004 he joined Lyon Communities and led its Inland Empire land acquisition and planning.

An Unwelcome Report

Frechette says he saw storm clouds gathering. In 2006, “we were supposed to be building that region up to 1,500 units a year,” he said. Using data from Lyon’s considerable mortgage operation, he warned his bosses: “To have home-price affordability based on who our buyers were, home prices out there had to drop 52.8%,” he said. Not surprisingly, his analysis wasn’t welcomed but was ordered for other regions.

Frechette sensed opportunity and began crafting a business plan aimed at banks. He left Lyon in 2007 on good terms and began studying FDIC bulletins and rounding up a team with a handful of senior advisors. (Those currently listed as advisors are: Wade Cable, David Philip, Eric Bergstrom, Michael Wright and Gage David.) Then he began meeting with bankers, telling them he was ready to advise on all the crappy real estate they were going to own.

Almost immediately Frechette says BofA handed him its “first project foreclosure in 2007.” And in 2008 the phone started ringing. Frechette’s other new bank clients soon were recommending – earning them credit for some vision – that he also start a receivership company.

Today, Land Interests, as the name makes clear, does it all: asset management, brokerage and investment advisory. The company bought an REO office building in the Irvine Spectrum. David Mudgett, an industry veteran and former Irvine Company retail chief, just stepped in as president.

Surrounded By Experience

In a Q&A with the OC Register recently, Mudgett reminded us that the typical five- to 10-year maturity dates only have started for the CMBS debacle’s peak loan tranches, totaling \$594 billion that were sold from 2005 to 2007.

In addition to banks, Land Interests clients include Adcuram, a distressed buyout group led by four principals in Germany that owns businesses in the U.S., Australia and Europe.

The company is steering a client’s land in Houston through environmental issues and is helping another develop a resort in Belize.

Frechette was a 2010 semi-finalist for Ernst & Young’s “Entrepreneur of the Year.”

Planning A New Fund

He’s planning a real estate investment fund of \$75 million that could include European money (let’s call it euros, for now) hedging U.S. property. If the currency arbitrage play hits, he said, the sky’s the limit. He said

he’s created the shell for a development company. He says development’s a ways off but it’s what he wants to do, eventually.

In the meantime, he organized Land Interests into the same kind of machine as the USMC, where, he says, “It’s not good enough to say, ‘I’ll have it for you next week.’ Tell me what hour of what day.”

“People underestimate the high level of professionalism in the Marine Corps, which can be mistaken as Marine Corp. You plan how you live your life in every 15-second window,” he said. Our sympathies to Mudgett.

Now healthy and fit, Frechette is old enough to know not to jump out of airplanes but still young enough to plan long term in 15-second intervals. Frechette’s come a long way from the small family farm in Hopkington, N.H., and he’s got a ton of ideas. So far they’ve paid off, which is good because a company named Land Interests has a lot to live up to.

Local REO Investor Plans Strategy Change To Rentals After REO Flipping Success

Tom Testa has been ridding banks of South Orange County homes that can be classified as the “cats and dogs” of the REO world.

With his partner, Aphrodite Hill, Testa is working in a tiny niche of buying and selling bank-owned über-fixers – about 70 of them in the last four years – giving him a unique view from the trenches of likely buyers, their motivations and concerns.

He’s also watched as banks have dramatically adjusted their disposition strategy from virtually refusing to deal on short sales. This came with some unexpected volatility in home prices nationally in the second and third quarters. Banks are “secretly waiting for the right time to release” REO homes for sale, he said.

With rental rates increasing, Testa’s strategy is changing from flipping to holding. He’s won approval for a \$100 million fund to build a portfolio of rentals. He said he may begin capitalizing the fund before the end of the year.

Savvy First-Time Buyers

“My opinion is that buyers for entry-level homes are typically Gen Y and very sophisticated. We call them spread-sheet buyers. They’ve done their online research and come to the property very knowledgeable about comps and what’s available. A lot have seen 20 homes. They know what they want. If the home is priced right, is in a good location with the right upgrades, it will sell

very quickly,” he said.

Here’s an example of a typical Testa deal, which closed in July: A four-bedroom home in Mission Viejo sold to a couple, first-time buyers with an FHA loan for \$469,000. Testa says he bought the property last fall for \$350,000 and invested upward of \$60,000 for renovation. The house drew five offers, two of which were full price and another cash offer from an investor. He said that escrow closed in 25 days, five days early.

Another nearly identical deal closed in Lake Forest in August. Four bedrooms, paid \$400,000, renovated, listed and sold in two weeks after two full-price offers. The buyers were a mother and daughter, first-time buyers, using FHA.

“My niche is buying homes that need renovation and especially those requiring a cash buyer. I can negotiate on those because they’ve been on the market and the lenders can’t sell them,” he said.

Bullish On Opportunities

In the real estate business since 1978, Testa has been based in the same Newport Beach building since 1981. Through the years, he’s had four companies all centered on real estate development, investment and financing. In 2006 he sold a mortgage company so the Testa Capital Group could focus on new opportunities.

“I’ve been through three previous cycles and I see more opportunity now than in any previous cycle,” he said.

Since 2008 he said he’s has little competition because most investors are “looking for paint and carpet jobs.”

Despite marketing homes that are drawing multiple offers he said that a lot of buyers are “sitting on the fence waiting for the perfect deal.”

Testa believes that home buying is hobbled by opposing forces. “If it was not for fear and uncertainty, many more buyers would be jumping in. There’s fear of shadow inventory, what’s left to come out.”

Those fears might be well founded. Earlier this year, Fannie Mae and Freddie Mac began foreclosing at record levels but the REOs are selling faster than banks are acquiring them. So it’s no coincidence that while the rate of REO saturation rose national home prices were declining.

This could explain why banks recently reversed course.

Testa says that from 2008 through 2010 banks were unwilling to deal with short sales. But this year, the banks’ attitude changed. Today, he says, 50% of his deals are short sales. His first short-sale acquisition in 2009 took a year to close. The next one a year later took six months. “This year it started speeding up.”