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San Diego value-added opportunities rise

By *Kaitlyn Mitchell*

Value-added opportunities in San Diego are rising as the city reaps the benefits of job growth and a lack of supply in the region. "Value-add opportunities in Class B and C product have seen the most growth over the last few years due to the lack of available land, creating a shortage of new development," said **Eugene Rutenberg,** director of **Continental Funding Group**, a Los Angeles-based mortgage banking company that is active in the region.

The firm recently secured $7m of bridge financing on behalf of an undisclosed borrower for the acquisition and renovation of a 25,000-square-foot office building with value-added potential in San Diego's financial district. The borrower plans to invest about $1.95m of capital to renovate the property, which will include dividing the space from a single-tenant to a multi-tenant configuration.

The renovations will allow the borrower to boost rents and draw more tenants into the building. According to **CoStar**, downtown San Diego's office market had average rental rates of $29.15 per square foot in the second quarter, with value-add Class B and C product seeing the most positive net absorption.

"Once the business plan is executed, the sponsor will easily be able to refinance the existing bridge loan into a permanent loan product," Rutenberg added.

San Diego is supply-constrained due to a lack of available land coupled with rising land and construction costs that make it difficult to build new inventory.

"Demand for office space is rapidly outpacing supply and the rate in which new development is entering the market continues to shrink, placing upward pressure on lease rates," Rutenberg said.

As the city becomes one of the largest West Coast tech hubs, more tech and biotech startups are migrating to the region. While Class A office commands the highest rents, Rutenberg is seeing a shift in demand for more cost-effective space. "As such, owners and investors are targeting these types of assets and converting them into modern, creative office type spaces," he added.

Despite the positive supply-demand fundamentals in San Diego, Continental found it challenging to line up a lender – partly due to the borrower's requirements: the borrower wanted a balance sheet bridge loan without any personal guarantees and a sub-7% coupon. "Most lenders will not underwrite a loan under such terms, especially for an unstabilized asset," Rutenberg said, adding that there is also lender hesitation over value-added deals. "Our strategy was to communicate the strength of the borrower's investment plan by providing rental comps to demonstrate the property's projected rental growth."