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Behind the Meltdown: As capital prices sink, investors are circling

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As Sacramento struggles with a real estate slump that's driven homeowners into foreclosure, home builders into bankruptcy and the region into a possible recession, big-time investors are smelling blood – and preparing to swoop in.

One failed property – an unfinished \$18 million condominium project near Cosumnes River College in south Sacramento – was recently sold to an Australian-born real estate investor operating out of the Bay Area. Consultants and brokers are preparing market studies for various clients – private equity firms, hedge funds, wealthy individuals – that have begun sniffing around Sacramento and other distressed communities in the West, prowling for raw land, half-finished projects and clusters of foreclosed houses.

The arrival of the "bottom feeders" doesn't mean the downturn is over. Far from it. Most analysts still say recovery in Sacramento won't begin until 2009 or later.

But the circling of the investors, however ruthless, is a predictable and even necessary stage in the real estate cycle as the region, battered by 29 months of falling values, tries to find where the bottom is.

"It's a precursor to a healthier market," said Dean Wehrli of the Sullivan Group, a consulting firm that's preparing studies for out-of-town investor groups. "The next step after that would be the slow beginning of a recovery."

In a way, the recent interest by investors shows how bad things are in Sacramento. The sheer drop in values the past two years – more than 25 percent for houses and a stunning 80 percent for raw land, according to one estimate – has put the region on national and international investors' radar screens.

"We are a market that has gotten some notoriety for how quickly and badly we've been hit," said Pete Nixon, a senior vice president and land-sales specialist in the Roseville office of commercial broker CB Richard Ellis. "So this is a market that people are going to look at."

The opportunities are arising because big landowners are going through the same struggles as individual homeowners: They bought at the peak, struggled to make payments and in many cases lost their properties to lenders. Now they're looking to move forward.

But there probably won't be a flood of quick deals. Many landowners, reeling from the sticker shock of collapsed prices, are leery of taking big losses. And potential purchasers see Sacramento as a fixer-upper – a long-term rehabilitation project that will take several years to pay off. Most are content to window-shop for now, and those who are buying realize they'll have to be patient.

It's all right "to ride the market down a little bit," said Ken Stevens, a Danville real estate investor who recently snapped up the unfinished Wolf Ranch Condominiums near the Cosumnes campus. "If you're in it for the long haul, what's the difference?"

An Australian native who's worked in international real estate circles for years, Stevens was drawn to Wolf Ranch because "it's a great area, an up-and-coming area." Once he finishes the project, he plans to turn it

into apartments – the condo market is simply too weak.

Wolf Ranch was the brainchild of Costa Communities of Colorado Springs, Colo., a condo developer led by former Sacramentan John Raptis. He envisioned 160 entry-level units spread over 18 buildings, complete with clubhouse, pool and toddler play area. Only 47 units were built when construction was halted about a year ago. Today the 9-acre parcel, surrounded by chain-link fence, is a hodgepodge of finished and unfinished two- and three-story buildings.

Raptis said the project was actually doing well but faltered amid a dispute with his lender, Umpqua Bank, which wound up foreclosing. While the collapse of Wolf Ranch has spawned multiple lawsuits, Raptis is philosophical about someone else stepping into his shoes.

"It's a cycle," he said. "It creates opportunities for other investors."

Stevens wouldn't say how much he paid Umpqua for the property, and closing documents haven't been filed yet with the Sacramento County recorder's office. Raptis said he poured about \$18 million into the project and assumes Stevens bought Wolf Ranch at a steep discount – as would any investor who's thinking of buying property in Sacramento these days.

"They're looking at it like, 'We want to go in and scoop up as much as we can for pennies on the dollar and then be able to just sit on it,'" said Kathryn Boyce, who follows the Sacramento market for Costa Mesa consultant Hanley Wood Market Intelligence.

"They're not just looking here," she added. "They're looking everywhere: Sacramento, the Central Valley, Reno, Texas, Phoenix."

Some investors are looking for packages of foreclosed homes. Scott Thompson, a partner with Mortgage Resolution Services in Carmichael, has been approached by representatives of out-of-town and overseas investment groups willing to invest up to \$100 million and looking to buy homes at 50 percent of their peak value.

"There's a lot of talk," Thompson said. "I don't think there's a lot of property changing hands yet. I think it will."

One reason deals are slow to happen: The landowners, whether they're bankers or builders or developers, are reluctant to swallow heavy losses.

"I don't have a shortage of buyers," said Jim Radler of Park Place Partners Inc., a Roseville land broker. "The problem is I don't have any sellers ... at the right price."

Park Place has been testing the market on behalf of banks that have taken over large clusters of land throughout the Central Valley. The results aren't encouraging. In the Sacramento suburbs, lots worth \$100,000 apiece during the boom would fetch barely \$20,000 today, he said. In some parts of greater Sacramento and the Valley, lot prices have reverted to farmland values.

"In many cases the banks are calling the shots and they're not ready to take the kind of haircut they need to take in order to sell," Radler said. He believes that attitude will change as the year progresses.

Potential land buyers include wealthy individuals and assorted builders and developers who have escaped the ravages of the downturn – "real buyers, ready to play," Radler said. Some have \$50 million to throw around.

On a grander scale, in September a Morgan Stanley subsidiary paid \$525 million for 11,000 residential lots around the country owned by home-building giant Lennar Communities of Miami. The deal left Lennar with a 20 percent stake in the lots. Although neither side would disclose where the purchases took place, several analysts said it's likely some of the land was in Sacramento, where Lennar has been a major player.

Another potential buyer is LandCap Partners, a startup founded by a former KB Homes executive intent on partnering with cash-strapped builders or buying their lots outright. One of the regions it's examining is the

corridor between Sacramento and Modesto, said Jason Glasgow, an executive vice president at LandCap's headquarters in Los Angeles.

Greg Paquin, owner of Folsom-based consultant the Gregory Group, said he's preparing feasibility studies for institutional investors looking at Sacramento and other Western markets.

"There's a lot of money out there. There's a lot of equity money, a lot of hedge fund money," Paquin said. "We've talked to individuals who have put together funds of \$100 million, \$200 million, \$300 million. They're looking throughout California, and Arizona is big now."

Meanwhile, the Sullivan Group consulting firm was recently asked to identify Western cities with downtrodden markets for a Los Angeles investment group looking for unfinished condo projects. Sullivan's conclusion: San Diego, Phoenix and Las Vegas are the most promising markets, with Sacramento not far behind.

Wehrli, vice president at Sullivan's Elk Grove office, said his firm drew up a list of 15 Sacramento-area condo projects of potential interest for the Los Angeles investors. He was willing to identify one of the projects to The Bee, because the project is so visible in the area condo industry: the Atlantis Rocklin Condominiums, where construction was halted more than a year ago and a court-appointed receiver has taken charge.

"The property has had a number of people look at it," said the receiver, Robert Greeley of Greeley Lindsay Consultant Group in Sacramento.

The Atlantis isn't the only project in play; Wehrli said other investors will soon descend on the Sacramento area.

"It's clear a lot of people with a lot of money are fishing around," he said. "They're trying to play the bottom of the market like a homebuyer is."

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