

## McCarthy Cook Tackles South Coast Metro

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By Murray Coleman

Sitting in front of a wall of windows at their Costa Mesa office, Thomas McCarthy and Edward Cook can see workers tending to rows of crops.

"I can see the headlines now: 'Development rises from the fields of Orange County,'" says McCarthy with a laugh.

Hardly rural and not at all off the beaten path, the 50 acres McCarthy and Cook purchased on a ground lease last year for \$95 million are moving closer to bearing fruit of the developers. Entitlements recently were completed for a planned 1.4 million square feet of campus-style office and retail development.

Bordered by Anton Boulevard and the Avenue of the Arts, 20 Acres of the site is undeveloped farmland. But the high-rise developments of the South Coast Metro area loom over the property, creating an undeveloped abyss in the midst of a heavily populated commercial district.

Only the San Diego freeway, which abuts the southern boundary of the property, breaks the array of buildings surrounding it.

"We were surprised to find such a large contiguous piece of undeveloped land in the middle of such a densely packed area," says Cook. "We had been scouring Orange County looking for properties and this jumped out at us."

Sporting a \$600 million commercial real estate portfolio, McCarthy Cook & Co. had plenty of resources to buy development rights. But they also had the financial backing of Blackstone Real Estate Advisors, a \$6.8 billion New York-based property investment group.

Since going into business for themselves nearly four years ago, McCarthy and Cook have worked several deals with Blackstone, which typically takes a lead equity position but lets local partners plan and supervise project in Southern California.

"They are young, aggressive and very disciplined," says John Kukral, senior managing director at Blackstone. "And they like to put their own money on the line to keep their level of commitment high."

### **Mixed-use Center on Horizon**

So a little more than a year ago, the trio joined forces. With plans to spend another \$140 million for a combined \$235 million investment, they are working to build anew mixed-use low-rise campus development, South Coast Metro Center.

"This is an opportunity to redevelop, reentitle and create a new master plan," says Cook. "We see this as a redevelopment project that can be tied to South Coast Plaza and a wealth of other amenities sitting right next door."

Cook, 35, and McCarthy, 44, began their careers as entrepreneurs after deciding in 1995 to leave positions with Maguire Thomas Partners, a Los Angeles based development company.

Cook was a vice president overseeing large projects while McCarthy was senior vice president of finance. Confident that the Southern California real estate market was on the verge of recovery from a severe recession, they decided to break away and form their own investment company.

## McCarthy Cook Tackles South Coast Metro

"It's never been about building an empire with us," says McCarthy. "It's about enjoying what you do and whom you work with."

Both went to high school in Orange County, Cook at Newport Harbor High and McCarthy at Foothill High School in Tustin.

The younger partner still lives in Newport Beach, commuting to the company's Los Angeles headquarters while doing much of his work from another office in Costa Mesa.

Each has Real Estate in his blood, too. McCarthy came from a family involved in real estate investments and Cook's father continues to practice estate planning in Newport Beach.

They both have MBA's, Cook from the Wharton School at the University of Pennsylvania and McCarthy's from the Anderson School of Management at UCLA.

"Each one has distinct strengths," says Anton Natsis, who is a friend of both and an attorney with Allen, Matkins, Leck, Gamble & Mallory in Los Angeles. "McCarthy has tremendous talent related to financial markets and Cook's strength is more on the marketing side of the business. So they're a perfect tandem."

And one willing to take risks, according to Jerome Nourse, managing director of CB Richard Ellis in Newport Beach.

"The more complex a project is, the more interest they seem to take," he says. "They realize that with higher risk comes potentially higher gains. And that's what gets their capital sources excited, along with the fact that they're two very smart guys."

While other real estate investors might flinch at revealing their margins, McCarthy and Cook make no bones about their financial objectives. They say that setting strict parameters from the outset is essential to structuring the type of complicated deals McCarthy Cook & Co. targets.

"We and our investors aim for at least a 20% leveraged annual return on equity in all the projects we pursue," says McCarthy. "On a new development, our roll of thumb is a 12% return on cost."

Without a pause he adds: "If we can't pencil those types of numbers in from the start, then we shouldn't be doing the deal."

That's just the type of talk Blackstone's Kukral enjoys hearing.

"If there are significant challenges to a project," he says, "then we want to partner with a firm that has the talents of McCarthy Cook & Co."

Those who have worked with the developers point to two main characteristics they bring to projects: An ability to decipher what will actually work and a knack for finding ways to bring together diverse interests.

"We like to untangle layers of ownership and financial structures that can complicate a large development and find ways to restructure, reorganize and clean up deals," says Cook. "If you can accomplish that, more options become available. And that creates opportunities to build more value into a project."

### LA Coup

Last year, the developers made headlines by completing a reorganization of Wilshire Courtyard in Los Angeles. The property, consisting of two mid-rise buildings and total of 1 million square feet, had accumulated \$365 million in mortgage debt.

## McCarthy Cook Tackles South Coast Metro

“It was the largest single asset bankruptcy in Los Angeles County history and it took us 15 months to battle through the (U.S.) Bankruptcy Court to wind up with ownership,” says McCarthy.

W. Toliver Morris, leasing manager for McCarthy Cook & co. at South Coast Metro Center, recalls listening to brokers and developers in the area wondering what was going to happen. He believes the trouble started when CalFed negotiated a lease from the building’s previous owners of 500,000 square feet at below-market prices.

“CalFed wound up going through a series of layoffs, which put them in a position of having to vacate quite a bit of space,” says Morris. “That left a lot of negative absorption in the building.”

Although some of it was subleased. CalFed was filling Wilshire Courtyard with tenants paying low rates.

With almost half the space vacant at Wilshire Courtyard, McCarthy And Cook say an opportunity to cut deals that would benefit all involved.

“They basically bought the debt at a discount and made a deal with J.H. Snyder Co., the original developer, and their pension fund advisor that was also involved in the buildings (LaSalle Partners),” says lawyer Natsis.

McCarthy and Cook also worked out an agreement with FedCal to terminate its lease.

“It too a huge amount of work,” says Toliver. “They had to forge a consensus among several different parties and work through the courts, too.”

Today, Wilshire Courtyard is 96% occupied and stands as one of McCarthy Cook & Co.’s most highly publicized success stories.

“It’s probably worth twice as much now as the day they closed on the property,” says Natsis. “That deal brought them a lot of recognition.”

Another high-profile development has been China Basin Landing in San Francisco. The 728,000 square feet of converted warehouse space was purchased by McCarthy Cook & Co. in late 1997.

“It’s south of Market Street, away from the heart of the city’s financial district,” recalls Natsis. “It wasn’t exactly considered a prime place to invest in a large office complex.”

But McCarthy and Cook say they saw signs the area surrounding the property was becoming a hotbed for technology companies.

So they set about redeveloping the buildings, outfitting the remodeled space with equipment and floor plans catering to a specific segment of the high-tech market – telecommunications providers.

### Good Timing

“Their timing was impeccable,” says Frank Wheeler, senior vice president of Colliers International in San Francisco who brokers deals near China Basin Landing. “They bought into the buildings just as the market was declining. Since then, rents in that submarket have almost tripled.”

Tenants now leasing major portions of China Basin Landing including MCI, Microsoft, Sprint and Quest.

## McCarthy Cook Tackles South Coast Metro

"The area around there, which is called Multi-Media Gluch, has benefited from the growth of dot-com companies," says Wheeler, considered one of the top investment brokers in San Francisco. "They (McCarthy and Cook) have attracted a good broadband community of tenants to their buildings."

Plans are under way to add another 180,000 square feet of office space to the site.

"They've doubled the value of their original investment on that one too," says Natsis.

In the South Coast Metro Center deal, McCarthy and Cook were faced with 500,000 square feet of class A space that was less than half occupied.

The partners' land deal with Sakioka Farms included two of three office buildings in the southwestern corner of the site. Each 12-story tower has 250,000 square feet and is considered prime space in the high-end South Coast metro submarket of Orange County.

The third tower remains in the hands of a German investment group being advised by Amstar Group Ltd. in Colorado.

### Improved Occupancy

When they took over last August, McCarthy and Cook not only faced low occupancy in what buildings existed but a need to gain approval from the city for 200,000 square feet of additional entitlements to fill out their master plan.

"It was a difficult deal from those aspects," says Cook. "We already had 1.2 million square feet of entitlements, but that just wasn't enough for what we wanted to do."

Recently, with final approvals for the last set of entitlements completed, deals with several retailers and restaurants have been finalized. Already signed up are: Quizno's, a sandwich shop; coffeehouse operator Dedrich and Robeck's Juice.

Next month, contractors are set to begin construction of a Romano's Macaroni Grill at Anton Boulevard and the Avenue of the Arts. A 24-Hour Fitness Club is also scheduled to go up at South Coast Metro Center.

By next spring, crews are also expected to be working on at least one new 130,000-square-foot low-rise building at the site. Also coming are three more campus-style office buildings totaling 350,000-plus square feet, restaurants, more retail shops and a 200-room luxury hotel.

"We see it as a diamond in the rough," says Cook. "It's just the type of project we like to sink our teeth into."

But South Coast Metro Center is not the last project McCarthy Cook & Co. plans to undertake in the area.

"This is such a technology-oriented market," says Cook. "It will continue to grow and we will continue to look for more opportunities in Orange County."

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