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Investor's Solo Act Is a Hit in Houston

APF Sold Office for 27% More Than It Paid a Year Ago

Tenaris SA, a supplier of oil-field piping and a tenant at 2200 West Loop South, purchased a 10-story office building near the Houston Galleria earlier this month from APF Properties. *MATT HUDGINS FOR THE WALL STREET JOURNAL*

By
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HOUSTON—When APF Properties was seeking a partner to acquire an office building in this city's ritzy West Loop/Galleria area, it was turned down by 60 investor groups that considered the deal too risky. As a result, APF ended up buying the building solo.

A year later, it has proved to be one of the best investments in the 19-year history of APF, a New York real-estate firm with commercial properties in New York, Philadelphia and New Jersey.

APF this month sold the 10-story building—2200 West Loop South—to the property's lead tenant, Tenaris SA, for about $47 million, according to a person familiar with the transaction. The sale price was 27% more than the $37 million that APF paid in August 2013 to buy the building, which is just off the main highway connecting the business, retail and residential district to the rest of the city. Tenaris is a Luxembourg-based company that makes steel tubes for oil and gas companies.

"This was a classic real-estate play," said Berndt Perl, principal of APF. Mr. Perl said the transaction gave his company a 60% return on its equity. Mr. Perl believes the price APF paid for the property in 2013 was such a steal that he remains mystified that his firm wasn't able to lure other investors. "We just couldn't understand why we couldn't find an institutional partner to joint-venture this with us," Mr. Perl said. "We were showing everyone the advantages."

Those advantages included a 4-acre site facing the highway and moments away from shopping at the nearby upscale Houston Galleria, as well as restaurants, hotels, office buildings and residential towers.

So why did investors pass on APF's investment offer in 2013? Though it is the fourth-largest city and a leader in job growth, Houston still hasn't shaken its history as a boom-and-bust city whose fortunes are tied to the oil-and-gas industry. Houston was the scene of one of the nation's worst regional recessions, following the oil boom of the 1970s. Then in the first half of the 1980s, after the city roughly doubled its supply of office space, massive layoffs triggered by collapsing oil prices soon created a crippling oversupply of empty or "see-through" buildings.

Some investors believe Houston is overdue for another bust. David Carter, a principal at Colliers International's Houston office, says such concerns are especially acute for office buildings with below-average lease rates that are locked in for four years or more, as was the case with 2200 West Loop South. Mr. Carter said many investors in Houston are reluctant to gamble on buildings with leases that preclude the opportunity to increase rents within that time frame. "Longer than three years, people start to get nervous about where the market is going to be," Mr. Carter said.

But APF saw things differently. "Houston is a boom-to-bust-perceived town, but our investment thesis is that, because of fracking and [advancements in] the oil industry, that boom-to-bust has turned to boom-to-boom," he said. "Because of the changing energy situation, this market is going to sustain itself for a longer time."

APF also believed it would be able to raise rents at 2200 West Loop South when leases were renewed. Mr. Perl said annual rent on more than half of the space in the building was $18-$20 a square foot on a gross basis, which includes taxes and shared building expenses. The average Class-A rental rate in the West Loop was nearly twice that amount, or $35.47, in the third quarter this year, according to Colliers. Rental rates at 2200 West Loop South, a 40-year-old building that is ranked at the lower end of Class-A, was even below the Class-B average of $26.71, according to Colliers.

APF expected to boost rental income 45% or more by bringing rents up to market rates when the existing leases began to expire. "We just didn't see the risk of it," Mr. Perl said. "It was a screaming buy."

So buy APF did, assuming an existing mortgage on the property and adding a subordinate loan to come up with the purchase amount on its own. But rather than wait until 2017 to begin raising rents, or pursuing an alternate plan of replacing the parking garage with another office tower, APF cashed out of its purchase this month by selling to Tenaris, which occupies roughly half of the building as its base of U.S. operations, according to Luis Baston, the company's planning manager.

Tenaris is investing $1.5 billion to build a seamless-pipe factory southwest of Houston in Bay City, and wanted to own its Houston offices. "Due to this expansion, we decided to make the building our permanent home," Mr. Baston said. He declined to discuss financial details.

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