

THE PROPERTY REPORT

Savvy Investor Bows Out of Denver

Steve Leonard, Market Timer, Casts His Eye on California

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MANY HERE BELIEVE that Denver's commercial real-estate market has a glittery future. So what does investor Steve Leonard know that they don't?

In a move that has worried some of this city's longtime real-estate holders, Mr. Leonard, operating through Pacifica Holding Co., has cashed out of the local real-estate scene. In a bold move, he is selling the bulk of Pacifica's portfolio of 8 million square feet.

He is also leaving town and moving to California, where real estate is rebounding.

It is a decision that has surprised his rivals. During the past decade, Mr. Leonard has proved himself one of the shrewdest real-estate investors west of the Mississippi. Yet at a time when Denver's market is still rising, Mr. Leonard is packing up shop. "Steve saw the future," acknowledges Don Cook, president of Denver's DPC Development Co., a longtime competitor. "He started buying at the very beginning of the recovery, and I'm just hoping that he didn't sell at the peak."

Pacifica sold the last of its portfolio in late February, when Mack-Cali Realty Corp. of Cranford, N.J., paid \$188 million for 1.4 million square feet of office properties, including 11 new suburban buildings. Kimco Realty Corp., New Hyde Park, N.Y., took over Pacifica's 630,000-square-foot retail portfolio in January, while First Industrial Realty Trust Inc. of Chicago picked up 4.2 million square feet of industrial space in October.

RETURNING TO HIS ROOTS

The acquisitions mark the debut of those REITs in Denver, where growth has attracted the attention of other REITs, including Equity Office Property Trust in Chicago; CarrAmerica Realty Corp. in Washington, D.C.; and Crescent Real Estate Equities Co. in Fort Worth, Texas. Still, some now wonder whether the Denver market will continue to post the dramatic gains seen in years past.

In his windowless, ground-floor office in the Denver suburb of Englewood, Mr. Leonard, 43 years old, downplays his abilities as a market timer. But "trees don't grow to the sky," he adds. Mr. Leonard is firmly convinced that the Denver real-estate market has fully recovered. "It's much more difficult now to make the kind of returns we made," he says.

As a result, Mr. Leonard is returning to his Southern California roots, where he will work for Mack-Cali, helping the REIT expand into the still-recovering California market. He also will oversee the REIT's activities in Denver. Separately, Mr. Leonard will continue as a minority partner in Pacifica Capital Group LLC, a sister company to Pacifica Holding, which controls 3.5 million square feet of space in Los Angeles environs.

Mr. Leonard was raised in Los Angeles, in a family where real estate was frequently the topic of dinner conversation. After graduating from the University of California at Los Angeles, he went to work for his father's real-estate investment and development business. Later, he joined his brother, Robert, and a friend, Steven Ohren, in a start-up



John S. Dykes

business, Pacifica Holding Co. In 1988, with the California market still sizzling, Pacifica sold much of its Los Angeles portfolio. Mr. Leonard then set his sights on Denver, where the commercial real-estate market was depressed.

BASIC ECONOMICS

With the backing of such investors as Jenny Craig, and O.J. Simpson, who invested through a retirement fund, Pacifica Holding eventually accumulated one of Denver's largest real-estate portfolios.

"Our mission was to grow as quickly as possible," recalls Tim Gudim, a Pacifica vice president who now serves as First Industrial's regional director. Pacifica acted as a real-estate service business, handling acquisitions, management, leasing and development for investors who came into various deals as owners or partners. Principals in Pacifica Holding owned less than 10% of the portfolio, a modest stake.

At the time, another entrepreneurial investor, Marcel Arsenault, chief executive of the closely held Colorado & Santa Fe Land Co., was certain that

Pacifica was growing much too quickly. "I thought Steve was making a mistake," recalls Mr. Arsenault. "But in hindsight it was me making the mistake. I'm stuck here with a business half his size, wondering what happened."

Mr. Leonard, who keeps a copy of Roger Lowenstein's "Buffett: The Making of an American Capitalist" within reach, was unfazed by prevailing sentiments. "If you have growing demand and fixed supply, you have a rise in values," he explains.

Some of Pacifica's properties returned their initial investments in cash distributions within 30 months. The portfolio eventually averaged more than 35% annual returns, including cash flow and appreciation. "Every deal we didn't do, we wish we had done," Mr. Leonard says.

During that period, he worked every day. Ski trips, dinner dates and tennis matches usually included business associates. And weekends were mostly spent fielding calls from investors and employees. Mr. Leonard says he took time out for himself, along with his wife and two young children, "but I was constantly worrying about what had to be done."

By 1994 the deep discounts Pacifica had grown accustomed to enjoying were becoming harder to find. The company shifted gears to new development, but many investors were cool to the idea. Undaunted, Mr. Leonard began hunting for institutional capital sources to fund Denver's first wave of new construction.

LOWER RETURNS

Mr. Leonard's search led to Apollo Real Estate Investment Funds headed by Leon Black, an ex-Drexel Burnham Lambert executive, and William L. Mack, who chairs the executive committee of Mack-Cali. The companies created a partnership in 1996 and built 15 new buildings in less than two years.

But even with Apollo by its side, Mr. Leonard says Pacifica had a difficult time competing with the publicly traded REITs descending on Colorado. "They were willing to take lower returns," he says.

For Pacifica, selling its holdings to the REITs enabled the company to dispose of its properties in bulk, while allowing investors to choose whether to take their profits or contribute their interests to the trusts on a tax-deferred basis. Some investors opted to hold, leaving about 25 properties that will be managed by the REITs.

For the buyers such as Mack-Cali, the purchases provided a critical mass of properties and local expertise in a marketplace they are targeting for expansion.

"Denver has recovered," says Mitchell Hersh, chief executive officer of Mack-Cali. "It's a maturing marketplace. But it's still in high demand because it offers excellent quality of life, along with population and job growth." Bruce Etkin, chairman of Denver's closely held Etkin Equities Inc., a real-estate investment firm, says he, too, remains confident in the local market. Nonetheless, he intends to either find a joint-venture partner or a buyer by year end.

Adds Mr. Arsenault of Colorado & Santa Fe, who plans to hold onto his properties: "It worries me a little bit that Steve thinks it's the time to sell, and I'm not selling," he says. "I'd sure like him to be doing what I'm doing."