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As Duke prepares to leave, reality sets in

After the REIT announces its departure from Northeast Ohio, real estate officials are wondering how good can the Northeast Ohio market be.

By STAN BULLARD

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Realty developers and partners Ed Schwartz and Jonathan Berns quipped that they'd broken open champagne on news that Duke Realty was leaving town.

Then, reality hit.

"It's a sad day when one of the large investors says it doesn't want to be in your market," Mr. Berns said. "If they thought there was a future, they'd stay."

Shock and disappointment are the prevailing moods in the Northeast Ohio realty world following Duke's disclosure that it plans to divest its local holdings and slowly exit the region for growth markets. One of the biggest cuts may be to the region's image: If a publicly-traded real estate investment trust such as Duke sees greater opportunities elsewhere, how good can the Northeast Ohio market be?

"To have someone of that caliber say they don't want to be in Cleveland is disturbing," said William Miele, senior vice president of Colliers-Ostendorf-Morris Co., after a *Crain's Cleveland Business* reporter briefed him on Duke's exit strategy.

Even so, Mr. Miele added, "Frankly, I don't think they'll have any trouble selling their portfolio."

Steve Egar, the broker at Beachwood-based Egar-Steiger Associates, said that coming after the region's loss of the headquarters of BP and TRW Inc., Duke's exit adds to fears that Cleveland is losing more of its status as a big-league city.

"It's another element of uncertainty," he said.

Among those surprised by Duke's plan to exit the market is Richard Moore, a REIT analyst at KeyBanc Capital Markets, a division of McDonald Investments Inc., who noted Duke didn't telegraph its decision earlier this month at the big National Association of Real Estate Investment Trust trade group's national meeting.

Duke has needed to get investors and analysts excited "about its story," Mr. Moore said. The REIT's $1 billion sale of industrial properties in eight cities last month, which halved its Northeast Ohio industrial portfolio, helped the company show growth to investors, he said.

“That was a case of selling industrial properties that didn't fit a plan to focus on bulk-distribution properties,” Mr. Moore said. “It's very different from saying, ‘We're going to leave Cleveland.’”

The biggest risk to businesses in the Cleveland area, said Robert Redmond, senior vice president of CB Richard Ellis, is if some of the new-breed buyers snapping up commercial properties around the nation, many known as "tenant-in-common" partnerships blending multiple investors, overpay to land some of Duke's premier office properties. If such investors can't hit their numbers and fail, he said, tenant services could suffer.

The bright side

But it’s not all bad news. There may bewinners in Northeast Ohio from Duke's planned departure.

"This is good for the Geises (industrial developers Fred and Greg Geis), Ed Schwartz and Jonathan Berns, Pat Finley Donald King and Pete Snavely," Mr. Egar said. The Geis brothers are industrial developers and the others named by Mr. Egar all are local Northeast Ohio-based developers of office and industrial properties.

Since Duke manages its own properties, the sale of its properties to various groups also will create opportunities for fee-based property managers.

For its part, Duke tried to put the announcement in the softest terms possible and made it clear it wants to extract top dollar for its investors. In other words, there's no fire sale here as the company is selling from strength.

The Indianapolis-based real estate investment trust has not yet put a for-sale sign on any of its holdings, said Wayne Lingafelter, Duke senior vice president and head of its Independence office.

Momentous move

Duke's decision to sell will be momentous for the market in terms of transaction volumes; it has some of the newest, largest office and industrial buildings in the market with top-tier tenants. It also has been dogged by office vacancy, particularly in the Rockside Road office market.

All told, Duke's portfolio ranges from North Olmsted to a just-launched business park in Hudson. Its portfolio includes 23 office buildings, a total of 2.2 million square feet of office space. It also owns 11 industrial buildings, a total of 2 million square feet of warehouse space. Duke entered the market in 1996 by buying eight suburban office buildings from former realty developer, now restaurateur, Ross Farro.

But that's a small part of its national picture for Duke. The REIT owns 113 million square feet of industrial, office and retail properties in 14 metropolitan areas.

Duke has been an active developer and acquirer here through this year. It's building a huge warehouse in Strongsville for World Almanac and last year bought the former OfficeMax building in Highland Hills. Its office portfolio includes properties such as the Park Plaza office buildings in Independence, Great Northern Corporate Center in North Olmsted and the Landerbrook I, II and III office buildings in Mayfield Heights.