

# Commercial Mortgage Insight

®

Reprinted with permission from the May 2006 issue.

## Condo Deals And Higher Construction Costs Pose A Double-Whammy For Affordable Housing

The fact that multifamily investors have garnered huge profits over the past few years from selling assets into a strong condo-conversion market has been well documented by industry analysts and observers. The mountain of multifamily properties that have been (and currently are being) converted into for-sale condos continue to plough forward, albeit at a slower pace. Most industry research points to expected growth in these transactions well into the next year.

Additionally, developers across the country have been reporting increases between 25% and 35% in the cost of new construction and rehabilitation projects. These increases, according to a broad range of development and construction managers, are driven by rising demand for building materials and the escalating cost of skilled labor. Much of the blame for this cost-push inflationary effect on new construction (across both the commercial and residential space) can also be attributed to high demand from overseas (led by Asian countries), as well as the rebuilding efforts along the U.S. Gulf Coast region following last year's hyperactive hurricane season.

Add to this an overall growing demand for housing and a booming national real estate sales market, and one can easily understand why the affordable housing sector (often overlooked in strong real estate markets) has suffered under the weight of neglect.

So, how have investors and develop-

ers in the affordable housing space - particularly in the for-rent multifamily sector - fared in their quest for acquiring land and buildings for construction and redevelopment projects? The answer to this pervasive question lies in the stiff competition these players must cope with coming from the market-rate multifamily sector.

Herman Bulls, president and chief executive officer of Vienna, Va.-based Bulls Capital Partners LLC, a commercial real estate loan origination and intermediary shop with a significant affordable housing finance platform, says that his developer and investor clients are facing similar problems, regardless of the regions they operate in.

"The condo-conversion craze, while tapering off, has created huge issues resulting in the inability of affordable housing developers to compete on price for properties in strong, active markets," Bulls tells *CMI*. He points out that quick closings for all-cash deals are winning the battle all day long, and that affordable housing developers must rethink their strategy of how they bid for properties in these active urban markets.

Bulls believes that one of the disadvantages faced by affordable housing developers and investors is the longer timeframe



Herman Bulls

required for the finalization and approval of tax-credit bond financing and other sector-specific financing options. He says that sellers today cannot be expected to wait for the longer deal-closing timeline

of affordable housing buyers, in the face of rich offers from potential condo conversion buyers.

"Being able to close quickly, for cash, is the big issue of the day for these players," Bulls says, pointing to the ample supply of private (often hard money) funding for market-rate buyers to snap up available value-added prop-



The Chicago office of Uniondale, N.Y.-based Arbor Commercial Funding LLC recently provided a refinancing loan of \$10.8 million for a portfolio of HUD Section 202 loans under its FHA Section 223(f) product line. Catholic Charities Bureau of Superior, Wis., is the owner/sponsor of the portfolio, which consists of 18 properties totaling 342 units. The facilities are all designated as affordable/subsidized housing for senior citizens.

erties. "The long lead time that allowed a developer in the past to control a property, while going through the tax-credit and bond application process, is just not realistic any more."

Bulls notes that as a result of this shift in the marketplace, there is a great need for acquisition and predevelopment programs to allow affordable housing developers to take down properties quickly like their market-rate counterparts do. He also says that the asking price of available properties "is making it difficult for the fundamentals of many affordable housing projects to work in certain cases."

The other issue, affecting the ability of developers to win bids for affordable housing projects, is the rising cost of construction. According to one developer recently interviewed by *CMI*, "The rising cost of development

goes directly to the bottom line, and is especially difficult to handle when rents are not growing at the same pace."

Bulls points out that construction costs for his clients have skyrocketed since Hurricane Katrina and the other storms hit the U.S. last year, adding fuel to the fire. He finds that the fundamental numbers for affordable housing projects - depending of the specific nature of a project - can change so radically, that some deals must be scrapped.

"Affordable housing deals are being cratered all across the country as development costs have continued to climb," notes Bulls. "This has been the result of a prolonged situation of rising construction costs while rents have stayed flat or only experienced modest growth."

Evidenced by the move of local municipalities to press for mixed-

income housing as a prerequisite for approving purchase and development or redevelopment, the success of affordable housing is critical to several parties of interest. Bulls' suggestion of preacquisition and predevelopment programs to make affordable housing investors and developers more competitive in the bidding process is being borne out by the prerequisites of many local municipalities.

Even though many current municipal programs place a greater emphasis on mixed-income developments (designed for more moderate-income residents) the quest for housing programs that aid the low-income community continues to elude some developers. That sector continues to lose housing stock to the market-rate multifamily space, particularly the for-sale condo market. ●