THE REAL DEAL

www.therealdeal.com NEW YORK REAL ESTATE NEWS Vol. 6 No. 11 November 2008 $3.00

November 2008

DEVELOPERS SCALE BACK

Footprints shrink in tough times

Builders shift to smaller towers, and hundreds of planned units disappear

By Alison Gregor

The end of cheap credit could end plans for many large apartment projects and office towers, as scarce and pricey financing prompts developers to shift toward smaller projects.

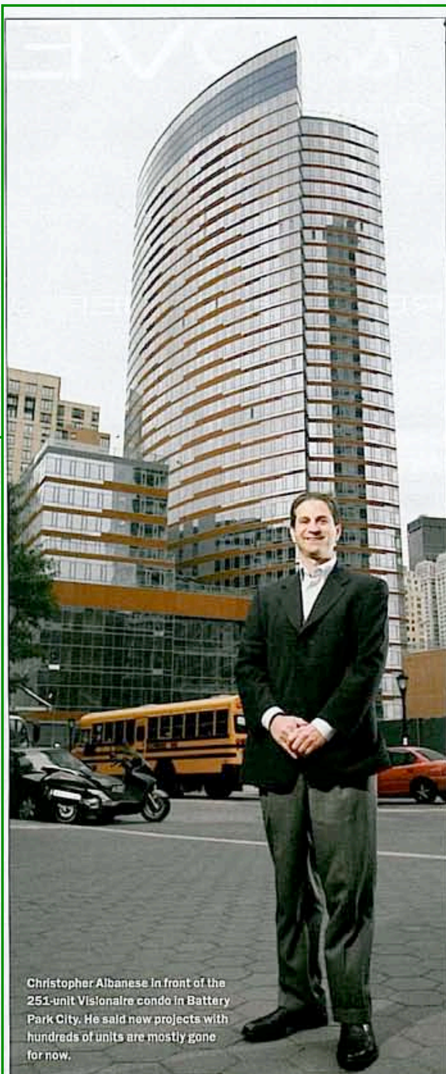
"That happened the last time (during the downturn of the late '80s and early '90s)," said Jeffrey Katz, the CEO and principal of the residential and commercial property development company Sherwood Equities. "In the early part of the recovery, developers who had before only done very large deals were willing to do much smaller deals, and I think that's smart."

Christopher Albanese, the principal of the commercial and residential development company the Albanese Organization, agreed that the days of residential projects with hundreds of units may be gone for now.

"I think the larger, experienced developers will do smaller projects," Albanese said. "Large construction loans now are very difficult to obtain, so I think as the market comes back, you'll see the smaller projects first."

He said the Albanese Organization, which is developing a 251-unit Battery Park City condo building called the Visionaire, would consider scaling back.

"Right now, we have a half-million-square-foot condo going up, the Visionaire, but if the right small site became available, we would consider developing a much smaller project than we might normally do, because they're less risky," Albanese said.



Christopher Albanese in front of the 251-unit Visionaire condo in Battery Park City. He said new projects with hundreds of units are mostly gone for now.

Property developers said financing is still available, but construction loans, especially those over about $50 million, are coming with much more onerous loan terms. Recourse provisions are more stringent, required interest reserves are larger, and banks are demanding that developers put in more equity, typically 35 to 40 percent.

"Going out for a $200 million construction loan in this market would be impossible without an enormous amount of recourse," Albanese said.

"I heard of one large loan where the developers were on for 100 percent recourse, and that was unheard of a year or two ago," he said, though he wouldn't reveal any more details about that transaction.

Greg Belew, a co-founding partner of the development firm Fifth Square Partners, said that with smaller banks stepping in to replace larger money lenders that have disappeared, financing will be abridged, which means smaller projects.

"I think developers are going to become more reliant on local- and regional-sized banks to get deals done, and that's certainly going to indicate smaller deal sizes," Belew said.

Belew, whose firm is working on the Steelworks Lofts, an 88-unit condo conversion in Williamsburg (see story on page 22), also said loans over $50 million are tougher to secure. A $50 million loan translates to an approximately $75 million project of about 50 to 60 units in Manhattan, or a project of less than 100,000 square feet, depending on land costs.

"I think you're going to see, for the time being, fewer of the 150- to 200-unit-plus developments, unless their construction financing is already in place and committed," he said. "I think you'll see more boutique-type developments. I would define a boutique development as anything from five to 50 units."

Some of the larger development companies said they'd consider becoming involved in smaller projects in a depressed market. Gary Barnett, president of the Extell Development Company, which has done a succession of very large condo buildings in Manhattan, said the company "might look at some smaller projects that we wouldn't otherwise look at" in order to "keep the shop busy."

Jeffrey Levine, the chairman of Douglaston Development, which does condo and rental buildings with hundreds of units, said his company would contemplate getting involved in small-scale developments in hard times like the present.

"The bottom line is, big deals are going to have a very difficult time getting done in these next few years," Levine said. "What you may see is developers, in order to keep their staffs occupied and continue the business to the future, will move to smaller jobs where there is less risk and less equity requirement."

However, both Belew and Albanese said that if larger developers are sitting on land owned free and clear, they will likely wait out the sluggish market rather than build smaller.

At Sherwood, which owns several development sites around Manhattan, including a residential one on the far West Side, Katz said the company plans to do just that.

While development plans have been drawn up for the site on 10th Avenue between 35th and 36th streets — a 200-unit residential building is envisioned — Katz said development will commence only upon favorable market conditions.

"I don't think this will be a good year [to start a new building]," he said. "I don't think next year will be a good year either, but we've owned the site for 20 years, so if we own it for 23 years before we build it, it doesn't matter to us.

"Whether it's office or condominium, the next year or two probably won't be a good time to develop it," Katz said.

Other developers of large projects agreed they would rather warehouse or sell the land than shrink the size of a planned project. That could mean waiting until the market would allow them to build the project to the maximum size allowed under the zoning.

"In New York City, if you have the ability to build, and you own the land, you're very reluctant to build smaller than you're allowed to," Barnett said.

However, Levine said developers might have a hard time carrying land through a prolonged market downturn.

"Generally, if you own land, and you have significant debt, you are in between the proverbial rock and a hard place," he said.

Levine said he anticipates those developers will seek out partnerships with larger development companies that still have good access to financing.

When lenders were handing out financing to "anyone with a heartbeat," novice developers typically focused on the boutique projects. Now, banks won't even consider lending to developers without an extensive track record, Levine said.

Tim Crowley, a managing director of Flank, a design development firm that focuses on boutique projects with only a handful of units — typically outsized condominiums — said he will be watching to see what larger developers do. But he said he doesn't believe there will be a major trend toward boutique development among the big players.

"Big development firms, like the Related Companies and Vornado, aren't going to start looking for small projects," Crowley said. "I think what you might see is developers and equity sitting on the sidelines until they can find really quality distressed assets to reposition. I don't see a lot of them using their infrastructure to tackle a 50,000-square-foot project."

If one thing is for certain, it is that developers will be getting creative to pull off deals.

For instance, the hotel developer John Lam downsized when he couldn't obtain enough financing to build a 660-room Sheraton hotel near the South Street Seaport in the Financial District. He is hoping to break the $250 million project into two smaller hotels, one of which will be a 220-room Sheraton.

Lam said he is making arrangements for one bank to finance one hotel and another bank to finance the other.

"Right now, credit is very tight, and our company is still getting credit, but over $100 million from one bank is difficult to get in this market," he said. "So we divided the project."

However, other property developers said they doubted that would be done with residential projects. "With major development projects in Manhattan, that would be difficult to do, as you could imagine," Levine said. "You can't say, 'I'm going to build floors two through eight now, and next year, I'm going to do floors eight through 12.'" TRD