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Real Estate Finance

Benefits Abound from Developer, Lender, Community Partnerships

By DAVID M. TEITELBAUM
President, Teitelbaum Holdings Ltd., New York

The startling shifts in the U.S. economy over the past several years are bringing dramatic and fundamental changes in the way urban real estate will be developed and financed in the future.

Once, developers could count on an endless supply of easy mortgages from a wide variety of sources for just about any type of project they had in mind. Today, mortgage financing has withered drastically, thanks to the energy crisis, soaring inflation and prohibitive interest rates, and real estate developers are now hard-pressed to find money from any source at any price.

Dismayed by skyrocketing construction costs and prodded by the government to restrict credit, lenders today have become less and less interested in putting their money into traditional real estate relationships. A 13% return on debt is just not attractive in inflationary times. Neither is locking up money for 30 or 40 years on speculative deals when there is little confidence that market interest rates will remain stable.

Thus, banks and thrift institutions have begun to rethink their role in the development scheme. More and more are coming to the conclusion that the only way in which they can viably participate under today's changed economic conditions is to become a full-fledged partner in the development process.

In increasing numbers, financial institutions have begun joint-venturing urban development projects of all kinds. They are seeking out those successful developers who have the capabilities to guarantee completion, performance and price. And they are benefitting from the equities in a project, not just the return on its debt.

These institutions are finding distinct advantages in such a relationship. For one thing, the financial benefits are substantial; in addition to interest, the lender splits the profits 50-50 with the building (its traditional role for many years), but now is committed to sharing the risks and enjoying the financial rewards of a specific venture.

Governmental involvement has come about through the increase in adaptive re-use of distressed urban structures. Specialists in this area are looking more and more to under-utilized public buildings as excellent sources of conversion candidates. These wonderful old structures exist in cities across the nation. By enlisting the aid and cooperation of local city agencies — by making them, in effect, partners in the work — developers have been able to take advantage of some unusual conversion opportunities.

This is especially true if the conversion deals with a landmark structure. But here, developers must expect to take on a lot more than one governmental partner.

Our most recent efforts are concentrated in New York City. One example is the recycling of the former Federal Archive Building in Manhattan's Greenwich Village. The project is unique: it is the first transfer of a national monument for re-use as a residential, commercial, recreational and cultural facility. But it also stands as a classic example of what developers of urban property can expect to face in the decade ahead.

In its planning, financing and construction, "The Archives" project contains all the ingredients of the changed conditions mentioned above. Thus, it may prove helpful here to look at this unusual project in detail.

First of all, the conversion of "The Archives" is consistent with a pronounced trend in many cities of turning old commercial structures into mixed-use buildings. With skyrocketing construction and financing costs pricing new for-sale apartments beyond the means of most first-home purchasers, the re-use of existing buildings has proven to be an attractive alternative for both developers and home buyers.

Such structures offer developers architectural features impossible to duplicate at today's prices. Their rehabilitation can be accomplished at a fraction of the cost of new housing. Hence the number of for-sale apartments created from old factories, warehouses and office buildings in cities is increasing throughout the country.

Another trend is the planned development of "The Archives" as a mixed-use facility of cooperative apartments, commercial space and cultural and recreational activities. Developers are beginning to realize that the numbers will not always pencil out in a large complex devoted entirely to housing. And that the addition of complementing non-residential facilities will not only

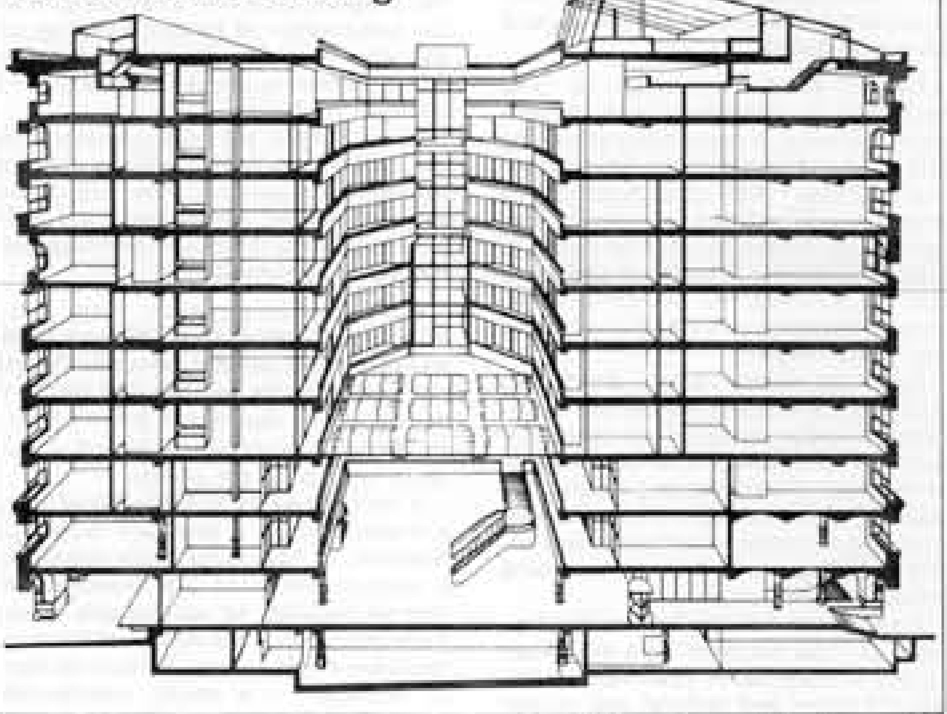
developer. For another, since lenders are forming these ventures with only the more substantial builder/developers, they are helping to ensure that their investment stands the best chance of paying off.

Moreover, lender money in such a relationship is tied up for a relatively short period — usually, no more than three years. And since the developer more often than not is required to front-end the initial costs, the lender is not really putting up anything at first except a commitment to provide money.

become, in effect, a subsidiary of a big developmental firm. The large builders, in turn, will spin off joint ventures with small, regional development concerns. Thus a whole series of inter-related partnerships will emanate from the new developer/lender arrangement.

This trend in America has just begun, although Europeans have done business this way for years. It will be the classic business shake-out; the strong will survive and the weak will disappear or align themselves with those better equipped to carry on.

Federal Archive Building



The impact of such a partnership on the building community will become even more apparent as the decade progresses. Small builders, increasingly shut out of the developer/lender partnership, will have to rely on the credit and track record of a large builder and enhance a development's financial viability, but also make it infinitely more attractive to prospective residents.

Thirdly, the fact that "The Archives" is a historic structure is typical of a growing interest in landmark and national monument buildings by urban developers. These structures abound in cities thoughout the Eastern seaboard. They often can be purchased from governmental agencies for creative adaptive re-use; cities see such re-use as an ideal answer to their acute shortages of apartments and commercial facilities.

Finally, "The Archives" conversion is requiring the complex interplay among developer, lender and government that surely will become a part of the urban developmental scene in the years ahead. Even in its approval phases, this project has involved more than 30 different public and private agencies — each with its own special needs and objectives.

Much of the groundwork for the transfer of this Federally-owned monument has been handled by the New York City Landmarks Conservancy, a local non-profit group. Its help was badly needed because this project has necessitated governmental approvals on city, state and Federal levels.

This building is being donated by the U.S. General Services Administration under the Historic Monument Act of 1949 to a subsidy of the New York State Urban Development Corporation. We are leasing the structure for 99 years under an arrangement in which our payment for the property goes into a revolving fund for preservation of historic buildings in the city. And our lease payments — which amount to about $10,000 a unit — are paid up-front.

We will create 350 large apartments in the building and they will be sold as leasehold cooperatives. We will retain the commercial, recreational and cultural sections of the project and lease out this space conventionally.

Our total development costs, estimated at $35-$40 million, will come from an institutional investor, who will also be our partner in the venture. The lender's money will be repaid on a priority basis. In addition to interest, the institution will share equally in the profits.

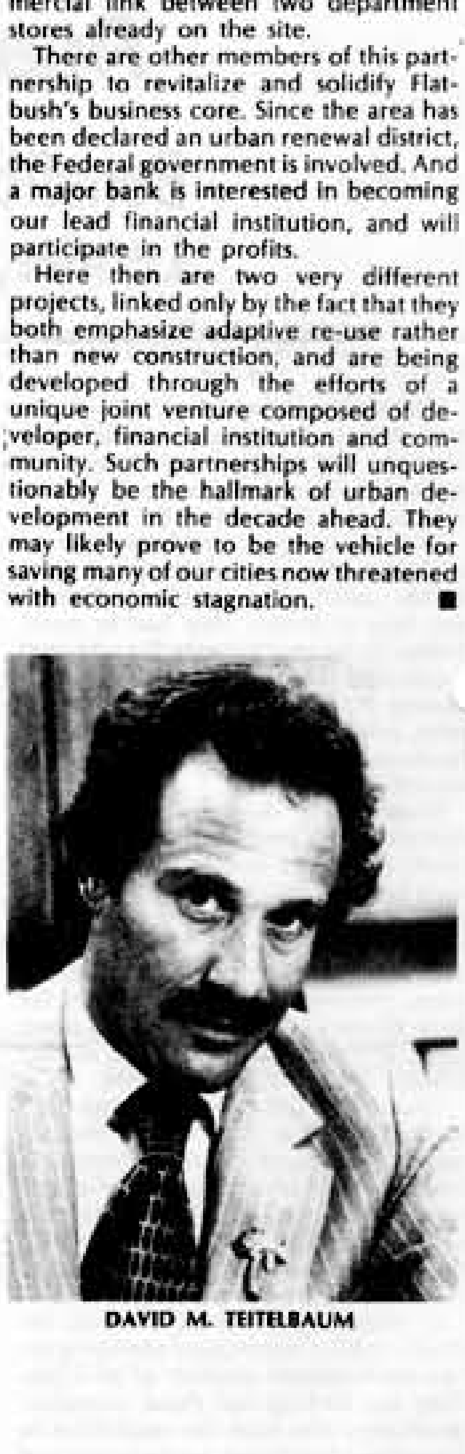
It isn't necessary to be involved with a monument or a landmark building, however, to have community groups as a partner, nor need the development contain housing. An apt example is our participation in a $20-million venture to revitalize the downtown Flatbush section of Brooklyn — a strictly commercial project which is also requiring a partnership among developer, lender and community.

Here, we are working with the Flatbush Development Corporation, a non-profit agency composed of people who live

Today's developer and lender must be prepared to make room for still another addition to their partnership. Recently, we've seen the emergence of the community as an active participant in urban developmental efforts. Government is not merely supplying incentives for and/or work in the area. Armed with $2 million of Federal Community Development Grants, the group has purchased the 4,000 seat Loew's Theater to save it from destruction. As the group's general partner, we will undertake the recycling of this incredible theatre into the heart of a new shopping center. We will also provide a 1,500-car parking facility and construct a 125,000-square-feet commercial link between two department stores already on the site.

There are other members of this partnership to revitalize and solidify Flatbush's business core. Since the area has been declared an urban renewal district, the Federal government is involved. And a major bank is interested in becoming our lead financial institution, and will participate in the profits.

Here then are two very different projects, linked only by the fact that they both emphasize adaptive re-use rather than new construction, and are being developed through the efforts of a unique joint venture composed of developer, financial institution and community. Such partnerships will unquestionably be the hallmark of urban development in the decade ahead. They may likely prove to be the vehicle for saving many of our cities now threatened with economic stagnation. ■



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