

LANSNER ON REAL ESTATE

By Jonathan Lansner and Jeff Collins



Condo revival? Wait 3 years or more!

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Lenders and investors are increasingly having to deal with “distressed” real estate projects, ranging from shopping centers with rising vacancies to incomplete developments and housing projects.

A new Orange County firm, Sycamore Urban Properties in Irvine, seeks to capitalize on this development by investing in condo developments that are in or near default on their loans. Projects include partially or fully complete distressed condominium or apartment-to-condominium conversion projects. Mitchell Bradford is Sycamore Urban’s president. The company launched its effort recently with the acquisition of a 41-unit, newly constructed townhome development in Rancho Cucamonga. We asked him to describe his new business in more detail.



Us: Define what you mean by “distressed” condo projects. What’s the status of these projects and how are they ending up on the market?

Mitchell: In fact, the property itself is not actually “distressed,” it’s the borrowed “Non-performing” is perhaps a better description for the assets we are targeting. The vast majority of properties under development in the past 2-4 years were financed prior to the major corrections we have seen in the housing market. Without the ability to refinance or fund more equity into now over-leveraged assets, the properties and borrowers have become distressed. As a result, the banks are doing one of three things: 1) performing workouts with current borrowers, 2) selling the notes at a discount or 3) taking back the property through foreclosure and selling it.

Us: How do you see the condo market in Orange County shaping up, and how soon will it take for the market to rebound?

Mitchell: Orange County will recover sooner than most other markets in Southern California, particularly the desert areas and Inland Empire sub-markets. As a prime coastal-oriented market, Orange County will once again become a vigorous center of jobs and new job formation after this recession. Just as emerging markets emanate outwards from core markets, recoveries will begin in the center and work outwards to secondary markets. The general lack of new home supply in OC eventually will fuel price increases, once demand begins to outstrip supply again.

Us: Why do you think this is a good time for Sycamore Urban to jump in and start buying them?

Mitchell: Sycamore Urban plans to acquire property and notes in the California, Arizona and Nevada markets, where condominium prices have declined as much as 50 percent, resulting in tens of thousands of units and

hundreds of properties and owners experiencing high levels of distress. Condominium prices in these targeted market areas are now trading at pricing significantly below replacement value. Markets can never be timed perfectly. We know, however, that the combination of absorption (sales) and prices peaked in mid- to late-2005 in our target markets. So from our perspective, it has been more than three years since the peak in the multifamily real estate market. Sycamore Urban's plan to steadily build a portfolio over the next 4-5 years, therefore, seems well-timed to coincide with the market's stabilization and eventual return to growth.

Us: What needs to be done to rehabilitate these projects once you acquire them?

Mitchell: There are no two properties just alike. Some properties require only clean-up and changing of the locks. Many other properties require more significant work to complete and stabilize the asset.

Sycamore Urban has the experience, expertise and relationships to develop properties from the ground up. However, strategically we have focused on properties that are 80% complete or more. These obviously carry less risk than a ground-up development, and there are more opportunities for acquisition of semi-complete assets. Our construction activities, therefore, may include (but certainly are not limited to) completion of offsite improvements and utilities, vertical construction completion, landscaping and final unit touch-up, etc. Physical completion of the property is just the first step in the property's stabilization. Sycamore Urban also will implement marketing and lease-up campaigns, followed by on-going property management ultimately resulting property disposition upon market recovery.

Us: You indicated you hope to rent out the condos you acquire until the market returns. But the rental market is softening. How will that affect your plans if rents keep falling and vacancies keep rising?



Mitchell: It is true that some forecasts reflect a softening rental market, at least in the short term. We simply factor such forecasts into our acquisition underwriting to ensure we are protected against fluctuations in rent and vacancies.

However, there are still strong factors that support the continued need for rental housing, particularly in Southern California. Population growth is expected to remain strong and the region has historically experienced an undersupply of new housing stock, particularly in coastal areas. In addition, the large number of home foreclosures unfortunately is shifting many households to rental units. Over the next few years, there will be an extremely limited delivery of new homes and increasing constraints, limitations and expenses involved with building new housing. Together, these factors will support long-term rental growth.

Us: What's Sycamore Urban's source of funds to invest in properties?

Mitchell: Sycamore Urban has established relationships with a number of sources of debt and equity, depending on the deal type and size. On the debt side, some banks are willing to finance the acquisition of their own distressed notes or properties in order to facilitate the transaction. This may increase the bank's ability to maximize their recovery. On the equity side, we currently are in discussions with small to large institutional and private equity funds that are seeking to invest in distressed multi-family income properties. Our goal is identify a source or sources of firmly committed funds for \$100 million in transactions over the next 12 to 18 months.

Us: When does Sycamore Urban hope to reach its goal of buying several thousand condo units?

Mitchell: We recently completed our first transaction, a 41-unit, newly constructed townhome development in Rancho Cucamonga and are actively seeking new projects. Although few transactions are occurring in this market today, compared to the volume of distressed borrowers and assets, we anticipate an acceleration of activity in the coming months. Sycamore Urban plans to acquire 300-400 multifamily units per year to build a total portfolio of 1,600 to 2,000 units over the next four to five years.

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