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OLDER BUILDINGS OFFER OPPORTUNITY FOR INVESTORS, CONTRACTORS

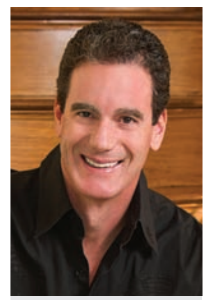
Class B and C multifamily assets that have seen better days can offer investors great rewards if they're willing to take on the challenge.

By John R. Donaldson

The economic recession that hit California with full force in 2008 turned the entire residential market on its head. In the preceding years, the race to homeownership was in full swing. This was fuelled by rapidly rising single-family home values and easy credit provided by financial institutions that seemingly never met a borrower who didn't qualify. All of this came to an abrupt end, resulting in job losses, bankruptcies and foreclosures decimating the condominium and single-family home markets.

With the focus clearly on homeownership, the multifamily residential market became the stepchild. Rental rates were static or decreased, and few new projects were built. While JDC Construction + Development Group had been involved in both the development and redevelopment of luxury single-family homes, the company's concentration since 1993 has been on restoring, renovating and revitalizing older apartment complexes. Working with multifamily property owners, insurance companies and others, JDC had restored numerous fire damaged buildings while revitalizing others.

The residential rental market began to come alive again in 2009. Many former homeowners who had lost their homes were searching for rental units. Others who previously might have qualified for mortgages were unable to access loans, while economic uncertainty produced a new category of tenant called "renters by choice." With little new product in the market, savvy investors began to turn their attention to the value inherent in existing multifamily properties.



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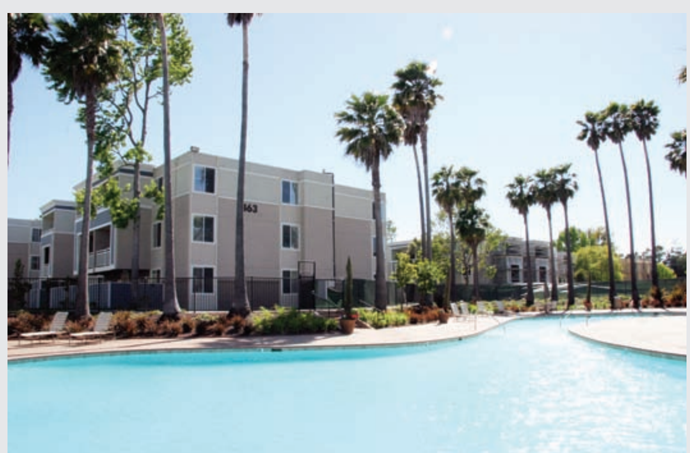
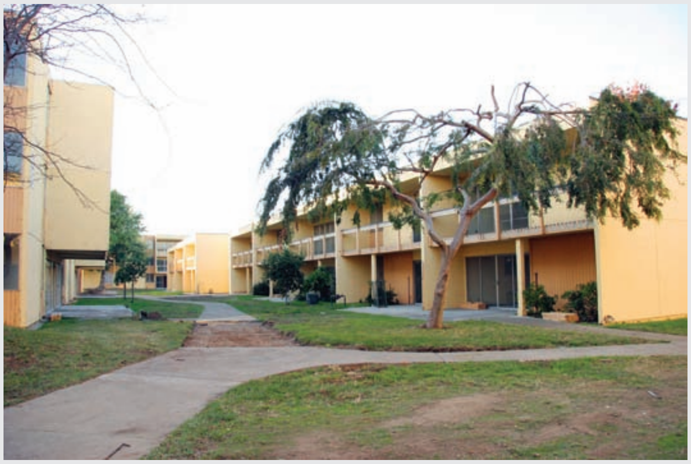
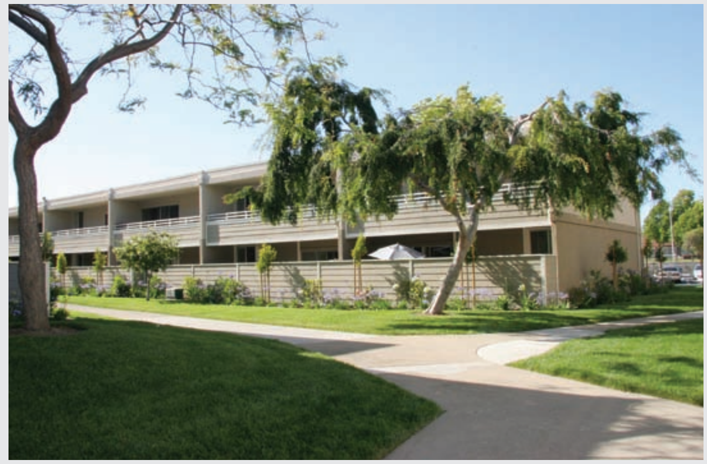
Institutional investors focused on Class A assets, but the competition



The 615-unit Summer House was originally built in 1965 as low-cost for the Alameda Point Naval Air Station. JDC executed a $35-million rehabilitation at the property, which is one of the largest multifamily properties in the East Bay area.



The unit interiors, the 16-building and Summer House's large pool all received signification renovations.

soon moved these investors to the sidelines. This left the field open for the private equity and other entrepreneurial investment groups willing to accept the risks and rewards of buying Class B and C multifamily assets. Since most of these were built in the 1960s and '70s, they required upgrading to add value and attract tenants. JDC has recently completed, or is in the process of completing, nine multifamily properties in Northern and Southern California. This includes a total of 1,400 units with a redevelopment budget of more than $19 million.

There are many challenges associated with the renovation and rehabilitation of existing older apartment structures. One of the largest challenges is undertaking the work while the project is still inhabited. Southern California apartment developments maintain an occupancy rate of more than 90 percent. Therefore, careful coordination is required to ensure tenants' lives are disrupted as little as possible while construction continues. JDC often finds that existing utilities are not in compliance with new codes, thus requiring new electrical and plumbing systems to be installed. One of the most frustrating issues the company had faced was dealing with the Los Angeles City Building & Safety Department. The staff was decimated by layoffs at the height of the recession, and has not seen its numbers increase despite the upswing in construction over the past 18 months. This leads to extensive delays in processing permits or inspecting properties. The issue is magnified because some cities have outsourced their plan checking, making it impossible to talk directly to individuals who are making decisions on these projects.

There are several emerging trends in the multifamily construction industry that bear watching. First, urban redevelopment will continue to be a major source of business. Cities are placing emphasis and, in some cases dollars, on attracting development and redevelopment in and around transit hubs and corridors. Since many of these regions have older commercial buildings, a lot of creative planning has to go in to updating these structures and converting them into apartment complexes.

Los Angeles is also beginning to survey residential structures that may be in need of earthquake retrofitting. A 2011 study by Caltech estimated that only 800 of the 20,000 so-called "soft story" apartment buildings in Los Angeles have been seismically strengthened. Soft story properties are defined as being no more than three stories built over a ground level with expansive openings containing car ports, parking garages or retail stores with large glass windows. Soft story construction was responsible for nearly half of all the damaged homes in the 1989 Loma Prieta earthquake.

JDC has completed dozens of these retrofits and, since Mayor Garcetti has indicated he intends to mandate the update of those properties found to be seismically deficient, the company expects this area to continue to be a major profit center.

Finally, the condominium market remains weak, with little or no new construction. The projects that have been built are in the luxury category and sales have been slow. JDC envisions a comeback in the condo market in the next year or two based upon the increase in single-family home sales. However, this will likely take place at the entry-level price range, which will probably require the conversion of existing rental units into smaller affordable condominiums. Once again, opportunity knocks!

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