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A developer fastens her seat belt

Most of the civilized world is aware of the American financial crisis and the national housing slump. As a real estate developer of mid-size boutique condominium buildings, I have been awaiting the downturn in our housing market since 2005.

The issue then and now is the exaggerated inverse relationship between various macroeconomic indicators. When prices fall, inventories rise. When sales volume decreases, unemployment increases. When banks lose money, borrowers provide greater liquidity. The willful obliviousness of our leaders once these indicators started appearing only to increase in severity is troubling, as they inevitably triggered the current economic chain-reaction.

I started my career in 1994 as a commercial real estate lawyer. Through much of the mid-1990s, I represented major developers in “workouts,” negotiated agreements between borrowers and lenders to restructure debt that the borrower is having a difficult time paying, thereby avoiding foreclosure to the mutual benefit of both parties. These debt restructurings made me keenly aware of both the symptoms leading up to the current bubble and the pains of recovery once it bursts. Back then, the legendary excesses of the previous boom market had already rolled by. I was involved in a triage of sorts, from representing a foreign investment consortium lending support to Trump’s West Side development, to facilitating the sale of a long-held building by a Helmsley Group syndicate, to refinancing the Mall of America. While the de-leveraging process was painful for most involved, the real estate market eventually did turn around, followed by an upswing.

If history is our guide, the good news is that even this housing slump will be cyclical, too. Whether we are facing a depression or recession remains to be seen, just as we do not know whether the root cause of our problems is a failure of free markets or of government regulation. We do know that since the Great Depression, America has faced periodic recessions lasting one to two years in duration. In each case, housing prices recovered within a decade.

Here is where the rubber meets the road for the mid-size developer. Today, the biggest challenge for every real estate professional is readily available cash. The excesses of the past decade left most developers overleveraged and undercapitalized. The credit crisis depleted monetary resources at banks, so they don’t have the money to lend.

I’ve talked with many developers over the past year, and most say the crisis has caused them to alter development plans. Repeatedly, I hear a couple of typical scenarios. If a developer was lucky enough not to have purchased a market-rate property and is now not obliged to close under a “hard” contract, then the developer will refrain from purchasing. If the developer is already holding property for development, then putting a project together in today’s market becomes akin to doing a New York Times crossword puzzle, and the day of the week depends on your creativity as a developer when meeting more complex challenges. For a mid-size developer, that means exercising the right to request more money from partners and investors to get the deal done, as costs and capital requirements increased dramatically in 2008 alone. The additional capital is applied to a range of budgetary line items, which are amplified in a housing slump, including increased costs for construction, increased interest payments, changed equity requirements, and filling gaps between the sales and bank release prices.

To survive, there are three choices for mid-size developers: bankruptcy, a moratorium on new projects, or partnerships. Established mid-size developers across the country have started declaring bankruptcy, most notably LA’s Livable Places and the Fort Lauderdale–based Levitt & Sons. Mid-size developers in New York are next in line, unless they are able to manage with current projects or by partnering. Many developers I know have chosen a mix of the two. They are managing current projects, but partnering on any future deals with mid- and large-size developers. In recent months, Sherwood Equities partnered with an institutional investor to buy 370 Lexington Avenue; GFI Capital Resources Group partnered with the Carlyle Group to buy distressed apartment buildings; and multiple mid-sized firms partnered to submit bids for the Starrett City development in Brooklyn.

Like other mid-size developers of recessions past, syndicating and partnering adds a layer of efficiency while lowering risks. Should some form of federal bailout plan arrive, liquidity issues may ease, providing further insulation in the short-term. Now is the time to reassess. For those who wait, the options may whittle down to bankruptcy, merger, or acquisition. That same final realization occurred on Wall Street in recent weeks, with firms going bankrupt, merging, changing business structures, and being acquired. As a midsize developer, it is necessary to find the formula that works now, making it possible to hold on until the turmoil settles. In time, this too shall pass.

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