
Mom-and-Pop Tenants • Property Condition Review
Commercial Investment Real Estate
JOURNAL
September/October 1997
CCIM
Multifamily Housing Trends
Compliments of
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Commercial Investment
Real Estate Institute

CCIM

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August 22, 1997

Todd D. Clarke, CCIM
John M. Henderson, III, CCIM
Lewinger Hamilton, Inc.
2340 Menaul, NE, Suite 200
Albuquerque, NM 87107

Dear Todd and John:

Enclosed you'll find two complimentary copies of the *Commercial Investment Real Estate Journal*'s September/October 1997 issue, which features the article you participated in called "Tales from the Trenches" by Sarah Hoban.

Thank you for your interest in our publication and for your contribution. Our readers are a select audience that requires practical, sophisticated information on commercial investment real estate. Thanks for lending your expertise and maintaining the quality that our readership requires.

Thanks again for your contribution. I hope I will have the pleasure of working with you again in the future.

Sincerely,

Catherine A. Simpson

Catherine A. Simpson
Editor and Publisher
Commercial Investment Real Estate Journal

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The *Commercial Investment Real Estate Journal* serves professionals involved in the commercial investment real estate industry by reporting on market trends and analysis, current developments in the field, and successful business strategies. The *Journal* strives to promote CCIMs' expertise within the commercial real estate community at large.

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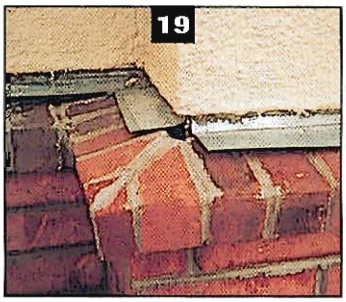
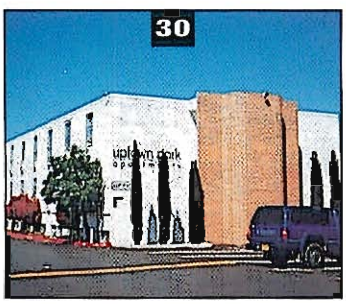
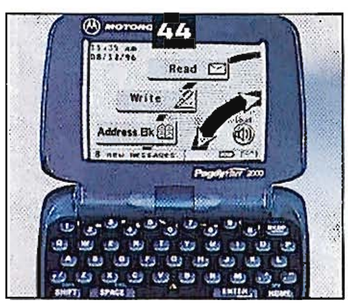






Cover photo: JPI's Jefferson Estates apartments, Richardson, Texas

From the

President's Desk

Looking Out for CCIMs

I'M SURE YOU'VE NOTICED THE FLURRY OF REPORTS in the past few months discussing the bills in Congress proposing capital gains and depreciation recapture reform and what the proposed changes would mean for commercial real estate. As you probably already know, CIREI certainly hasn't been silent about its stand on the proposed legislation.

When House Ways and Means Committee Chairman Rep. Bill Archer first introduced the House bill, which cuts capital gains and depreciation recapture but sets a higher rate for depreciation recapture than regular gain, CIREI realized the implications those changes could have on the commercial investment real estate industry. CIREI staff and members, who had been following several capital gains bills before the chairman's bill was introduced, reached out to the National Association of Realtors (NAR) prior to the introduction of the legislation to cooperate in getting our position heard: real estate should not be treated differently from other investments, such as stocks and bonds. The structure of the proposed bill would mean that many property owners may not receive any benefit from the proposed capital gains cut.

Your participation in CIREI's legislative efforts can make a difference.

Working closely with NAR on that particular issue, CIREI presented a call for action on capital gains explaining the changes' effect on our industry and provided access to NAR's toll-free phone number to connect you directly to your legislators so you could make your feelings known on the proposed changes.

Our affiliation with NAR strengthens our representation and clout with Congress. With a membership of more than 700,000 agents behind it, the NAR legislative staff lobbies Congress to get all our views heard on subjects such as depreciation recapture. CIREI's cooperation with NAR ensures that our commercial real estate interests are well represented.

Capital gains and depreciation recapture reform may be the most visible sign of CIREI's dedication to interpreting legislation and representing you in Congress, but it isn't the only effort. At the business meetings in June, CIREI reaffirmed its commitment to legislative affairs action by renewing our contract with the Institute of Real Estate Management for legislative services and the employment of CIREI's legislative analyst, Kristin Harrelson.

Having our own legislative analyst means that instead of trying to interpret how proposed legislation will affect commercial real estate yourself, CIREI will analyze the legislation specifically in terms of its impact on CCIMs and the industry as a whole.

To that end, our Legislative Affairs Committee, chaired this year by Cynthia Shelton, CCIM, of Orlando, Florida, coordinates legislative efforts and develops CIREI's views on legislation. Earlier this year, CIREI published a *Statement of Policy*, which reviews relevant legislation and analyzes its impact on commercial real estate. The State and Municipal Affairs Subcommittee—which now is 40 members strong—keeps members abreast of what's happening on the local level and is developing a library of information on topics that might affect others, such as commercial lien laws.

If you'd like to get involved in CIREI's legislative efforts or would like to begin receiving the *Legislative Bulletin* or the calls for action (both of which are available on CIREI's Web site at http://www.ccim.com/), contact CIREI Legislative Analyst Kristin Harrelson at (312) 329-6033 or e-mail her at kharrels@irem.org.

Daniel J. Page, CCIM
President

Retail construction activity has been very strong in Spokane County and along the Post Falls/Coeur d'Alene corridor, with more than one million sf coming on line this summer, Cromwell says. "Most of the new development has occurred in the outlying, suburban areas at the expense of downtown," he notes. However, an $80 million redevelopment project has begun in downtown Spokane anchored by Nordstrom, he says.

Seattle's retail vacancies are near 4 percent, according to Marcus & Millichap's *National Investment Market Report 1997 Forecast*. Rents and sales prices have leveled off as the myriad construction from 1994-95 has come online, but the positive job market and income growth have helped absorb the new space, according to the report. Several large retail developments and renovations are underway downtown.

1990s Good to Industrial

Spokane "has enjoyed a strong industrial market through the 1990s," reports Tracy Lucas, CCIM, of Kiemle & Hagood Co. "The industrial market is very tight for buildings that are for sale," Lucas says. "In fact, of the current vacancy [rate] of 5.9 percent, approximately 1 percent of that is buildings for sale. With this low inventory, the sale prices have increased over the last several years, and a user can expect to pay approximately $20 to $28 psf for a building plus the land." Several spec office/warehouse distribution facilities are being constructed in Spokane, he says. Typical industrial lease rates for new construction range between $0.30 psf to $0.40 psf per month, triple net for warehouse. Lease rates for existing such industrial space range from $0.15 to $0.30 psf per month, triple net.

Douglas H. Sylvester, CCIM, of Mercer Island-based Invesgro, just east of Seattle, sees strong industrial demand from distribution and transportation companies. He says occupancies range from 2 percent to 8.7 percent. Prices range from $40 psf to $70 psf for newer warehouse properties, $4.50 psf to $11 psf for land, and $90 psf to $130 psf for high-tech buildings.

Oregon: Controlled Growth

Just south of Washington in the Beaver State, Joanna Tompkin, CCIM, of Peregrine Properties, Ltd., in Beaverton, Oregon, says it's important to note that all developments are planned, "whether or not developers and users wish [it]," she says. "The state of Oregon has a 20-year comprehensive plan which details precisely where alternative uses may expand in the future. If one's project is not on the plan, it may be near impossible to accomplish a change of use. This control helps prevent an uncontrolled expansion-and-bust syndrome as seen in the L.A. and Phoenix markets."

Along those lines, a recent report from CCIM Gene Bentley's company, Norris, Beggs, & Simpson, characterizes Portland, Oregon, as "a place of continued growth and prosperity, of careful planning and measured progress." Bentley's report calls the office market in Portland a textbook example: "Increased demand + decreased supply = increased prices." Downtown vacancies are about 5.7 percent and rental rates have risen, with class A space going for around $18 psf. Suburban office vacancies have stayed under 5 percent.

Multifamily Prices Up

"Current activity is straining to meet investor demand for properties," says Mike Merrifield, CCIM, an investment real estate broker in Portland, of the multifamily market there. "Land is in short supply due to an urban growth boundary, coupled with a doubling of price in the last five years. Five years ago, Portland was in the top five cities for affordable housing in the country; currently we are in the bottom 10. I don't see this market cooling off for several years."

Multifamily occupancies in the Portland area run from 93 percent to 98 percent, depending on the submarket, he says. Seasoned properties lease for between $0.60 psf to $0.80 psf per month and newer properties from $0.75 psf to $1 psf, Merrifield says. Sales prices range from $42 psf to $60 psf on seasoned properties to more than $70 for new construction.

Seattle and Portland at a Glance

	Seattle	Portland
Metro Population	1.6 million	1.7 million
Selected Major Employers	The Boeing Co. Nordstrom Microsoft Corp.	Intel Corp. Fred Meyer, Inc. Kaiser Permanente

Sources: Greater Seattle Chamber of Commerce; Seattle-King County News Bureau; Norris, Beggs, & Simpson

In the Salem, Oregon, area, "With the passage of two property tax limitation measures, multifamily owners have experienced greater bottom lines, making most unwilling to sell until some capital gains relief is passed," says Doug Nelson, CCIM, of Coldwell Banker Commercial. Small properties (6 to 20 units) are the most frequently sold, recently averaging $35 to $45 psf. "The market is dominated by private rather than institutional ownership," Nelson says. "REITs are actively searching in this market now—and could become a major player within 12 to 24 months."

Retail and Industrial Expansion

In Michael Slewitzke's Eugene, Oregon, retail market, "Inmigration by companies is occurring and existing companies in our area are expanding." Retail occupancy in Eugene averages 95 percent, higher than previous years, says Slewitzke, a CCIM with Northland Real Estate, Inc. Lease rates run $5.50 psf per year gross basis to $15.60 psf per year, triple net, depending on size and location. Sales prices are up, ranging from $88 to $95 psf, and financing is readily available, he says.

In Portland, "New retail space cannot seem to be built fast enough in the metropolitan area," according to Bentley's report. Norris, Beggs, & Simpson projects retail vacancies of between 4 percent and 6 percent through the rest of the decade.

Portland's industrial market has been very active, says Terry N. Tolls, CCIM, of T.N. Tolls Co. Vacancies average 6 percent, but range from 1 percent to 14 percent, he says. Basic shell space leases for $0.31 psf to $0.33 psf triple net per month for larger product, with smaller spaces substantially higher, and the few remaining close-in sites commanding a substantial premium. Sales prices "have been going up so quickly that this is a very difficult item to keep tabs on," Tolls says. "In addition to the normal rise in labor and construction costs for various materials nationwide, we have the added problem of having to compete with an enormous amount of microprocessor plant construction. That is sucking up rock, concrete, and some labor categories (specialty trades such as electricians) at such a rate that overall construction costs have really gone up—which pushes the costs of existing buildings up too."

Still, substantial new construction is underway, he says. "We will no doubt get some glut in a few of these areas for a while, but our land supply is running short, thus the speculative development will slow," Tolls says.

Pacific Northwest Hospitality

Reports on the region's hospitality market vary by segment. Michael S. Courtney, CCIM, of Merlin, Oregon, calls the recreational property market—including recreational vehicle (RV) parks and campgrounds—strong. "There are many buyers looking for the lifestyle (mom-and-pop operators), investors looking for large, quality parks, and membership clubs seeking well-located parks for their members," he says. "Prices are all over the board because of the uniqueness of each property," Courtney says.

About 1,800 new hotel rooms are forecast for development in downtown Seattle and more than 1,000 rooms forecast for the East Side/Bellevue, says Laycock, who expects more new construction downtown, as well as an expansion of the convention center. "I only hope that the hotel owners and developers don't overbuild the marketplace," he says. Seattle's hotel occupancies are near 78 percent, up from 72 percent in 1994, he reports.

However, Richard Glanz, CCIM, of International Motel Brokers, Inc., in Vancouver, Washington, is less optimistic about the motel business. "Based on motel business to recreational areas, people are staying home," says Glanz, who adds that room income for most motel properties outside the major metropolitan peaked in 1994.

Regional Report is written by Barbara Bronstien, *associate editor of the* Commercial Investment Real Estate Journal.

Seniors, Lifestyle, and Low- and Moderate-Income Renters Will Drive Demand for Apartment Stock.

by Hessam Nadji

The U.S. multifamily housing market has benefited from the most stable supply-and-demand fundamentals of any property type for the past several years. As a result, at a time when many property markets, particularly the office and hotel markets, were overbuilt and suffering from falling rents and negative returns, apartments were posting strong rental growth and gains in values. Since 1990, average apartment rents have moved up at an annual rate of 5 percent and sales prices have escalated 4.5 percent per year on average. Yields have averaged 10 percent since 1993, making apartments the market leader for the first half of the 1990s.

However, some of the dynamics that helped propel the apartment market have begun to change. Having led the property recovery, the multifamily housing market is further along the current property cycle than any other property sector and is showing the characteristics of a maturing asset class. These characteristics include rising new construction, slowing rent, and income-based value escalation. Apartment sales prices continue to rise as investor demand bids up prices in a number of markets. Other recovering property types, particularly suburban office and hotels, have captured a large share of investment dollars recently by offering higher short-term gains in rents and values.

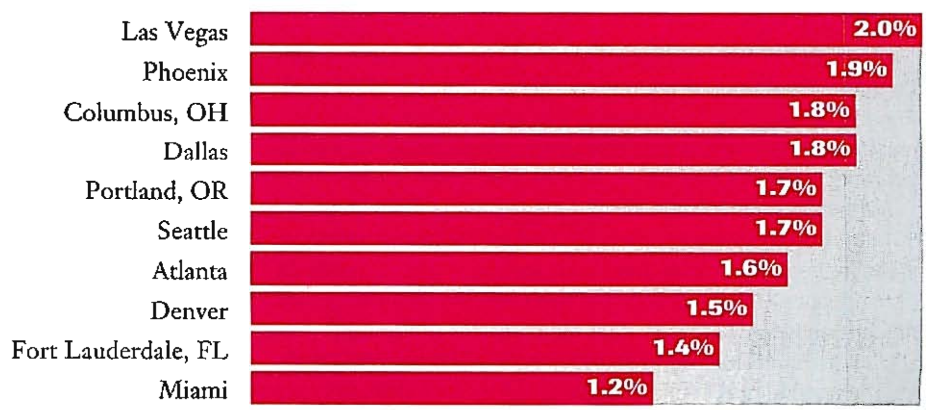
Of most concern to apartment owners and investors is the construction activity that was up 43 percent in 1996 compared to 1993. However, the 160,000 units of multifamily housing projected to start this year throughout the nation constitute 25 percent of the total units built in 1985, the last peak in multifamily construction. At the same time, absorption of new units has slowed. In 1994, 82 percent of all new units delivered were absorbed within the first three months of availability. The three-month absorption rate of new units fell to 72 percent in 1996. Absorption levels for the six-month period after delivery followed a similar pattern. In 1996, 87 percent of all units were absorbed in this time frame, compared with 94 percent in 1994.

Several markets, including Denver, Phoenix, Las Vegas, Dallas, Atlanta, and Austin, Texas, have experienced particularly high levels of construction and now are under tight observation for potential overbuilding. The vacancy rate of some of these markets has edged up slightly. However, this movement in vacancy generally has been limited to newly constructed higher-end units; class B rents and vacancies have not been affected to any significant degree. These markets also have appeared high on various job and population-growth rankings for the past several years and have absorbed the new supply for the most part. While the short-term supply-and-demand balance may get tilted in specific markets, no broad-based evidence indicates a downturn in the long-range outlook for the multifamily market. In fact, supply and demand are expected to stay more or less in balance.

◄ *The Jefferson Estates development in Richardson, Texas, is JPI's first "Project 2000" concept. It offers all the amenities and luxuries of a single-family home without the maintenance and overhead. Features include oversized Euro-style bathrooms, wood-burning fireplaces, nine-foot ceilings, gourmet kitchens, and electronic intrusion alarms. Services available include pet walking, plant watering, valet carwash, mountain bike and fly fishing rentals, maid service, and a video library. JPI is a Dallas-based multifamily housing developer with more than 7,500 units under development across the country. Photo: JPI.*

U.S. Apartment Construction

Highest starts as a percentage of total inventory as of June 1997



Sources: McGraw-Hill, Marcus & Millichap Research Services

While the returns and value escalation may not be as rapid in the future, the general stability of multifamily real estate investments will continue to attract investors.

Nationally, multifamily vacancies have been dropping and have remained the lowest of all property types. The national vacancy rate is projected to stay at less than 6 percent in 1997, despite continuing construction activity. Another sign of strength for apartment properties in relation to the other major property sectors is reflected in its low delinquency rates. According to the American Council of Life Insurance, only 0.48 percent of apartment property loans are delinquent, down from 1.5 percent a year ago and 3.5 percent in 1993. The overall delinquency rate for all property types stands at 1.8 percent.

Demand Drivers

The U.S. population continues to grow at a moderate rate, with a total of 62 million residents added since 1970. By 2001, the United States will have added 12 million people to its population base. The nation's population will climb by an estimated 45 million residents during the next two decades thereafter. At the same time, total households have grown by 57.5 percent, or 36.5 million, since 1970. Household growth in the 1990s is projected to total 12.7 million, or 13.8 percent.

Falling household density has been a contributing force behind the growth in household formation rates. In 1970, households averaged 3.2 people in the United States, compared with an average of 2.6 people in 1996. During the recovery from the 1990-91 recession, low interest rates and weak home price elevations helped increase U.S. home ownership rates. Since 1993, ownership has risen from 63.9 percent of households to more than 65 percent.

While this trend implies a negative effect on renter demand, the impact likely will be short term. Interest rates have been moving up again in response to consistent economic activity and show no evidence of falling soon. In the last 35 years, the U.S. home ownership rate has stayed virtually unchanged, despite short-lived movement.

Low- and Moderate-Income Renters

Households with annual incomes of less than $25,000 comprise 61 percent of all apartment renters, according to the U.S. Bureau of the Census. Low- and moderate-income households rely on older class

Luxury Apartments Suit New Lifestyles

Apartment development in the Phoenix metropolitan area continues its blistering pace, with construction levels at their highest in 10 years. In the past year, more than 8,500 units were added to inventory, while about 7,000 apartment units are anticipated to be completed in 1997.

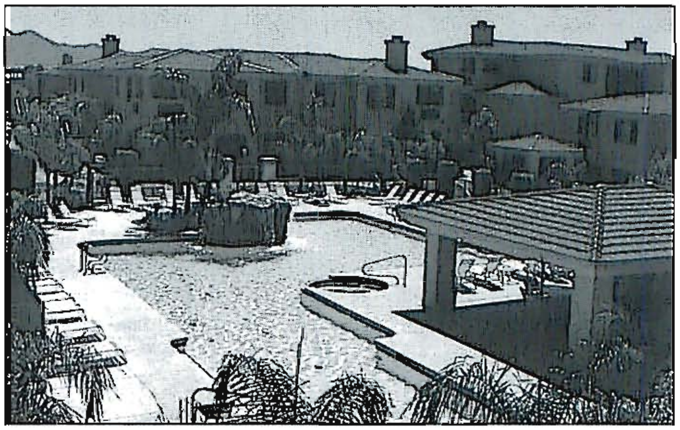
The majority of the new construction has been centered in A-type product targeted at the high-end, affluent lifestyle renter. These new multifamily projects usually are large in size, offer high-amenity units, and demand higher rents.

In the short term, these luxury properties may become vulnerable to oversupply resulting in higher vacancies, lower rents, and concession policies. Concessions already have reappeared in several submarkets as owners and property managers respond to increasing vacancies. However, given current levels of absorption, most properties that are offering concessions only are doing so on a limited basis.

A sample of the new luxury product coming on line is the Legend at Kierland, developed by Mark-Taylor Residential of Phoenix. Located in Scottsdale within the confines of a new master-planned residential community, the property opened in February 1996 and has just completed lease-up.

Within the immediate area, the median household income is $61,801, and the median age is 37. One of the fastest-growing areas in the metropolitan area, Scottsdale has grown nearly 29 percent since 1990; population around the property has grown 25 percent between 1980 and 1996. Home prices range from $50,000 to $5 million, with $160,000 as the average listing price.

The Legend at Kierland is surrounded by a 27-hole golf course and boasts mountain views. The fitness center has a variety of workout equipment, in addition to saunas and locker rooms. The development has an impressive schedule of other amenities available with its choice of 11 floor plans, which average 958 square feet: nine-foot ceilings, attached garages, microwaves, electronic access gates, fireplaces, walk-in closets, alarm systems, clubhouse, a lagoon-style pool, and tennis and volleyball courts. The typical resident is between 20 and 40 years old; 80 percent are couples; 100 percent are employed; and 80 percent are long-term residents.



Marcus & Millichap

The Legend at Kierland caters to lifestyle renters who don't mind paying for extra amenities.

Average rent at Legend at Kierland is $941 compared to a submarket average of $547 and a metro average of $578.

—by Matt Schneff, *research manager, Marcus & Millichap, Phoenix.*

B and C properties to accommodate their housing needs.

Foreign immigrants in particular represent a sizable segment of the low- and moderate-income households. According to the U.S. Immigration and Naturalization Service, the annual average number of foreign immigrants entering the U.S. legally has averaged 800,000 since 1990, up from 700,000 in the 1980s and 410,000 in the 1970s, placing a high level of new-renter demand on low- and moderate-income housing. The long-term outlook for immigration patterns is difficult to predict due to several measures designed to curtail the inflow of foreign immigration into the United States.

However, demand for affordable housing is likely to remain high, keeping the issue of government involvement in specialized financing for affordable apartment projects on the front burner. Easing the restrictions on pension fund investments in apartments, mortgage insurance programs provided by the Federal Housing Administration (FHA), the Federal National Mortgage Association (Fannie Mae), and the Federal Home Loan Mortgage Corporation (Freddie Mac) are aiming to create new financing alternatives for this sector.

First-Time Renters

Young renters (18 to 34 year olds) and older renters (65 years and older) will have an influential role in the future apartment supply-and-demand balance. The population of younger renters has fallen from 67.3 million in 1980 to about 65 million today. By 2001, the number of U.S. residents in this category is expected to fall to 64.1 million. Over this 20-year span, this segment will have fallen from 30 percent of the population to 23 percent. The drop in this segment is more than offset by the rise in older and lifestyle renters (who have an annual income of more than $50,000) on a national scale.

For the younger renter, the key benefit of apartment living is affordability. In many markets such as San Francisco, San Jose, California, and Chicago, where apartment rents are among the highest, low affordability has become a serious issue even for apartment renters. Apartment rents average $1,200 in San Francisco, $1,140 in San Jose, and $850 in Chicago.

Lifestyle Renters

The number of affluent individuals and families that choose apartment community living over single-family home ownership

Seniors Development Anticipates Demographic Needs

The demographics of the New Orleans market suggest that demand for seniors housing is strong and will continue to grow in the future.

Currently, the most populous age segments in the New Orleans market are 40 to 49 (16.89 percent of the total population) and 75 years and older (9.05 percent of the total population).

To meet what it expects to be a growing need, the Christwood Retirement Community in New Orleans opened in May 1996. The community has 118 apartments, an assisted-living section in a health center, and a skilled nursing facility with private rooms. The facility is privately owned by Christ Episcopal Church.

Population projections for 2001 show that the facility is located in an area where residents 65 and older will comprise between 10 and 30 percent of the population. Between 1996 and 2001, the number of residents in the immediate area 65 and older will increase by 7 percent. According to Christwood's associate marketing director, although the minimum tenant age requirement is 62, the youngest tenant is 71 years old; the oldest is 94.

The community has eight different apartment models, including two styles of one-bedrooms, five styles of two-bedrooms, and two styles of three-bedrooms. Entrance fees vary depending on the plan to which a resident subscribes. "Traditional plan O" residents receive a refund upon termination of the residence and care agreement only if the termination occurs within 90 months of the initial occupancy. Traditional plan O entrance fees range from $69,500 to $149,500. "Capital return plan 80" residents receive a minimum refund upon termination of the residence and care agreement of 80 percent of the entrance fee paid. Capital return plan 80 entrance fees range from $99,500 to $215,500. For both plans, a $10,000 additional entrance fee is charged for a second apartment occupant. In addition to entrance fees, residents also pay monthly service fees ranging from $1,050 to $2,555. If an apartment has a second occupant, the monthly fee is an additional $520.

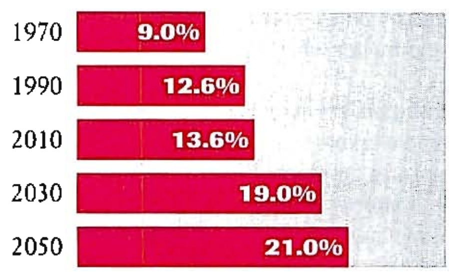
Amenities include multiple-entree meal service, daily continental breakfast, light housekeeping, personal laundry service, scheduled transportation, move-in assistance and coordination, health care on site, licensed nurse on duty 24 hours a day, a wellness program, planned social activities, 24-hour security, inside and outside maintenance, and trash removal.

Although most of the residents are from the New Orleans area, some are from as far away as Pennsylvania, Florida, and Oregon, according to the facility's associate marketing director.

—*by* Jennifer Trendler, *national research coordinator, Senior Housing Group, Marcus & Millichap, San Francisco.*

Seniors in America

Percentage of total U.S. population



Sources: U.S. Bureau of the Census, Marcus & Millichap Research Services also is growing. Frequently referred to as lifestyle renters, these individuals and families make up another growing segment of the rental market. According to the Census Bureau, 13 percent of apartment renters have household incomes exceeding $50,000 and fall into the lifestyle-renter category, a segment expected to continue growing at a modest but steady rate over the next two decades.

New apartment design and construction has changed in response to the fastest-growing segments of renters—seniors and lifestyle renters. Characteristics such as higher ceilings, garages, upscale appliances, advanced alarm systems, expanded club houses, business centers, and multiple phone lines for in-home offices are becoming common in new construction projects. More new communities also are offering extended landscaping and gardens, elaborate exercise facilities with more variety, after-school programs for children, and organized social activities.

Proximity to shopping, public transportation, and job centers also has become a vital factor in securing new development sites. Higher-end properties and facilities naturally have created pressure on retaining higher-end property management, maintenance, and tenant services.

As a result, larger units are built to accommodate expanded features and needs. The average size of new units constructed in 1996 was 1,075 square feet, compared with 880 square feet in 1985. Approximately 55 percent of all units built in 1996 had at least two bedrooms, and 13 percent had at least three bedrooms. Correspondingly, 38 percent of all units command rents of at least $750 per month. Average monthly rents for 19 percent of all new units built range from $650 to $749. The high-end luxury apartment properties have the highest short-term risk since only a small portion of the U.S. population can afford the higher rents.

Seniors Housing

The widely publicized aging of the U.S. population is a significant trend for multifamily housing rental demand. In 1970, 20 million U.S. residents were over the age of 65—9 percent of the total population base. By 2001, an estimated 45.5 million residents will be in this category, comprising 16.4 percent of the U.S. population. According to the U.S. Census, the shift toward an aging population will accelerate rapidly after 2010, and by 2050, 21 percent of the U.S. population—or 80 million residents—will be 65 or older.

The spectrum of senior resident multifamily living ranges from complete independent living in an apartment community to full-service facilities that offer healthcare assistance to seniors. The first group, frequently referred to as "empty nesters," are lifestyle renters by choice that seek the ease of apartment living, look to eliminate home maintenance issues, and take advantage of community-style amenities and general living conveniences that apartment communities offer. The other incentive for this rental category is the freedom to use home equity created over the years for other purposes.

Low-Income Housing Revitalizes Downtown

For entry-level workers and residents on fixed incomes, finding affordable housing in the central city—no matter what city—is a challenge.

Attracted by proximity to jobs, public transportation, services, and cultural amenities, middle- and upper-income workers increasingly are drawn to revitalized urban areas, and developers are responding with a building spree of upscale apartments and condominiums. That is squeezing low-income downtown residents out of the housing market. Yet, city planners and economic development officers desperately want to build an inventory of affordable downtown housing to ensure a healthy, economically balanced urban core.

One program that encourages the creation of affordable housing in urban areas is the federal low-income housing tax credit (LIHTC). Most often used for new construction in suburbs and small towns, LIHTCs also can be used to rehabilitate downtown structures, providing a safe, attractive environment for people living near or below the poverty level, while at the same time enhancing the existing community.

Portland, Oregon, boasts one such example. After more than 12 years standing vacant, the old Pine Street Building in the heart of downtown reopened this summer as the WestShore Apartments, with 113 units of affordable housing, and the Pine Street Garage, with 306 parking spaces.

The Arend Company

With the help of low-income housing tax credits, the WestShore Apartments will bring affordable housing to downtown Portland, Oregon.

The development was designed with three goals in mind: to produce decent, humanely sized housing at affordable rates for downtown entry-level workers; to provide nearby older commercial buildings with badly needed parking; and to integrate the architectural style and scale of the new development with the surrounding historic neighborhood.

Seniors that require living assistance and health care also are a strong consumer group. According to a recent survey by the American Association of Retired Persons, 69 percent of seniors who need care prefer living in a facility compared to living with family or friends. Developers are responding to this fast-growing segment of renters by accommodating various in-unit and community needs. Assisted-living developments offer services including meals, personal care, housekeeping, transportation, shopping, and household chores. These facilities have an average of 77 units, most of which have one or two bedrooms, a dining room, and a full kitchen. Most of these properties also offer common areas for social gatherings and activities. Developers are shifting more toward assisted-living construction to retain tenants previously occupying independent units. At the other end of the spectrum are licensed nursing facilities, which offer round-the-clock medical and personal care for residents with chronic medical conditions.

Apartment Investment Trends

Investor appetite for apartment properties has remained strong throughout the 1990s. As the market supply has tightened and demand has increased, improving cash flows and prospects for growing operating income have captured investors' attention. In the early '90s, when most property types were suffering from the economic downturn and overbuilding, apartment properties were posting a strong comeback and therefore became the most sought-after property type among investors.

Public market financing and equity funding for apartments have been increasing in the past several years. In addition to lowering the cost of capital, public market development funding has helped keep new construction in check by requiring significant equity investments on behalf of developers. Many apartment real estate investment trusts (REITs) were active in 1993 and 1994, positioning themselves to take advantage of a strong market. In these two years alone, apartment REIT initial public offerings totaled \$2.9 billion. In 1995 and 1996, there was very little IPO activity; however, secondary offerings totaled \$3.8 billion.

Although apartments have passed the peak of value appreciation on an aggregate basis, low vacancies and strong cash flows will continue to attract institutional and private investors.

Aside from temporary gyrations in the supply-and-demand balance in specific markets, long-term demand for multifamily housing will remain robust for the next two decades. Class B and C properties, many of which offer upgrade potential, will become increasingly important to investors.

About the Author

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The existing structure initially was designed by architect Pietro Belluschi in 1955 as an addition to the City Police Bureau. Due to budget constraints, only two of its eight floors actually were built. Developer Brian McCarl & Company adapted the existing two above-grade stories for parking and added three floors for new apartments, taking advantage of structural steel and a third-floor deck that lay unused for 40 years.

The \$7.2 million mixed-use project offers affordable housing to entry-level workers and low-income individuals with annual incomes of less than \$16,200. Most units are studios averaging 350 square feet, with rents starting at \$404 a month. Rents include electric appliances and heat, carpeting, smoke alarms, mini blinds, and cable TV access. The parking garage will be used by up to 38 WestShore residents and nearby office tenants.

Other building amenities include storage, laundry, lounge/vending area, bicycle parking, secured/valet parking, and 24-hour on-site management and security.

The building, which originally was a modest concrete structure, has received a new streetscape clad in brick, metal canopies, bay windows, and architectural features that help it blend in with the neighborhood. William Wilson Architects has maintained sensitivity to detail, color, and scale throughout the project, which is evident in such elements as an interior landscaped courtyard, terra-cotta colors, and exterior balconies.

The city of Portland supported McCarl's proposal because it replaces affordable housing that was eliminated by recent downtown development and it offers a desirable blend of public and private financing.

The Arcand Company, a full-service real estate investment firm specializing in federal low-income housing tax credits, led private investment in the WestShore Apartments property and arranged for a pool of investors to supply more than \$1.16 million in equity financing in return for federal income tax credits. Armed with that private-sector commitment, McCarl then was able to attract the state of Oregon and city of Portland as primary and secondary lenders, respectively.

The LIHTC remains the most effective means of financing the nation's affordable rental housing inventory. It is a proven model for creating attractive, safe, low-income housing with minimal government involvement, providing ongoing incentives for corporations and private investors to help finance affordable housing development through a federal tax credit. In the case of the WestShore Apartments, it also revitalizes an inner-city, abandoned building and enhances the urban core.

—by Robert Arcand, *founder of the Arcand Company based in Portland, Oregon, which sponsors and manages affordable housing investment portfolios. He has served as president of the Oregon State Council for Affordable and Rural Housing, and as a director of the Affordable Housing Tax Credit Coalition. He can be reached at (503) 598-9800.*

Tales from the Trenches

Brokers Share Their War Stories of the Fast, Slow, Complex, and Unexpected.

by Sarah Hoban

It's inevitable that whenever you get a roomful of brokers together, you'll hear a variety of war stories from the trenches. One may be the story of a broker racing the clock to pull off a deal, another could be the tale of a broker who had to sit tight to painstakingly piece a deal together. Whatever the story, the message is clear: Each deal offers its own lesson. Learn how each of these pros juggled complications such as the need for creative financing, tight timetables, and community opposition to get to their closings and satisfy their clients.

Dahlem Realty Company, Inc.

Community outcry over demolition related to the expansion of this Kentucky mall led to a compromise that moved some homes to nearby lots.

Sorting Out the Issues

Dahlem

Well-honed negotiating skills helped swing one of James Dahlem's most complex deals. Dahlem is a CCIM with Dahlem Realty Company, Inc., in Louisville, Kentucky, which manages a small shopping center in the Original Highlands neighborhood, a historic district.

In 1990, Dahlem Realty decided to expand the center, having previously purchased adjacent land containing several houses more than 100 years old. The homes, now multifamily dwellings, were in such disrepair, says Dahlem, that the company worried about its liability and decided to demolish them.

But the neighborhood association learned of the plans and persuaded the city's board of aldermen to place a moratorium on their demolition. One board member persuaded Dahlem and the neighborhood group to work out a compromise.

Dahlem credits CCIM courses in negotiation and sales for giving him techniques to help ferret out the main concerns. "We wanted to get commercial zoning to expand," he says, as well as deal with the safety issues in the derelict structures. He explained to local residents the necessity of keeping the center up-to-date so that it wouldn't lose tenants—including the neighborhood's only grocery store and drug store. The neighborhood association wasn't necessarily against the expansion, he says; it simply wanted to preserve the homes.

Focusing on the primary issues, says Dahlem, allowed negotiations to proceed. After several more years of talks, both sides reached an agreement. Two of the three residential lots would be rezoned for commercial use, and the two houses on these lots would be moved to nearby lots. The zoning deal was approved in April, and the houses were scheduled to be moved in the fall.

After the homes are moved, a local architect will restore them to single-family use, with help from the city—a satisfying ending, Dahlem says.

Dash for the Deal

Clyta Polhemus, CCIM, and Brian Velthoen, CCIM, of Velthoen Associates Commercial Brokers in Modesto, California, used teamwork to coordinate a July 1996 deal. The participants were geographically scattered; creative financing was needed, and the proceedings had landed squarely in the public spotlight. The deal also had to close within a week.

Velthoen Associates had listed for sale or lease a 42,000-square-foot building in Riverbank, about 10 miles from Modesto. In 1996, the property was under contract to the county school board as the site of a new school. But the deal was moving very slowly through approvals and due diligence.

In the meantime, telecommunications company MCI contacted the Stanislaus County Economic Development Corporation (SCEDCO), about using the property for a telephone relay center. MCI asked if it could submit a lease proposal for the building. Velthoen agreed, but emphasized that the property was under contract.

MCI's interest brought with it economic stakes that could affect the entire county: the relay center would open up nearly 700 jobs in a high-unemployment area. But MCI also needed to be up and running by October, putting Velthoen Associates in a bind: What could the company do until the school board made a decision on the property? Moreover, the prospect of 700 new jobs had attracted public and media attention.

Polhemus

Velthoen

Once the county decided not to buy the property, "everyone thought that [the MCI plan] was a done deal," says Polhemus. "That wasn't the case." A week-long marathon ensued, in which Polhemus, Velthoen, and a well-coordinated lineup of supporting players pulled out all stops to make the deal happen.

Several issues complicated negotiations. On July 14, MCI said it wanted to begin renovation on July 17, giving Polhemus and Velthoen 32 hours to put an agreement together. To do that, they had to deal with MCI's broker in the Bay Area; MCI's corporate headquarters in Denver; the company's attorneys in Washington, D.C.; and the property owner, who lived in a Chicago suburb.

MCI also wanted the landlord to put up $800,000 in improvement money as well as include a one-acre parcel of land—that wasn't part of the project—for an additional 113 parking spaces. (The building originally included 226 parking spaces.)

Refinance Cash Flow

MCI telephone relay center sensitivity analysis

Uses

Existing first mortgage	$1,400,000
Brokers' fee	$189,000
Real estate taxes	$25,000
Financing costs	
Appraisal	$3,500
Title and escrow	$10,000
MCI tenant improvements (TIs)	$808,500
Other	$25,000
Points	$35,000
Total estimated funds needed	**$2,496,000**

Appraisal Analysis

Appraised building value	$2,400,000
Appraised TIs value	$808,500
Total appraised value	**$3,208,500**

Loan to appraised value		
80%	75%	70%
$2,566,800	$2,406,375	$2,245,950

Cash flow from refinance

	County Bank	*Wells*	*Oak Valley*	*MBC*
Loan to value	70%	60%	75%	75%
First	$1,680,000	$1,440,000	$1,800,000	$1,750,000
Loan to value	100%	100%	75%	100%
Second	$808,500	$825,000	$606,375	$825,000
Total uses	$2,488,500	$2,265,000	$2,406,375	$2,575,000
Required	$2,496,000	$2,496,000	$2,496,000	$2,496,000
Add (take) cash	**$7,500**	**$231,000**	**$89,625**	**($79,000)**

The financing was complicated by the fact that the owner had acquired the property through an exchange, in which he had taken it on an all-inclusive with a silent assumption. "So the lender didn't know he was in ownership—and the loan had a call on it," says Polhemus. "So how do we get $800,000 in new capital, get the property refinanced, and know that this loan is in place before we commit to a lease?"

Velthoen, who has been in business in the community for about 20 years, got several local banks working on financing possibilities. The brokers contacted SCEDCO to investigate the possibility of public funding. They worked with the city of Riverbank to negotiate fire, parking, and other site permits. The owner flew in from Illinois on a Monday, and everyone sat down for a week of negotiations.

"On the second day, we realized that it all hinged on the financing," says Polhemus. "Either we had financing—and we knew what those terms were so we could work them into the formula—or we didn't have a deal."

Velthoen used planEASe software to compile a complete loan package with the owner in just four hours. "We did a sensitivity analysis," says Velthoen. "We knew what the result was, so we had to figure how to better price it to meet the objectives of all the players in the transaction. Sometimes that can take two or three days to do unless you have the right software to make it happen—so you need to invest in the technology to be able to produce that answer with certainty. That's what we were able to do in four hours." Polhemus adds that one of the banks' loan officers told her that Velthoen's ability to break down the components and do the financial analysis allowed the lenders to better recognize the individual components and speed up decisions on the financing process.

Because of its tight schedule, MCI needed to begin training operators, so Velthoen and Polhemus also negotiated with the owners of five vacant acres adjoining the property where MCI could set up recruiting and training trailers.

The upshot? A local bank agreed to the financing, and by 8 p.m. on Friday night, all parties had signed a letter of intent.

Both brokers credit the strong support they received at every step of the way. "This was really a team approach—there's no one individual hero in this transaction," says Velthoen.

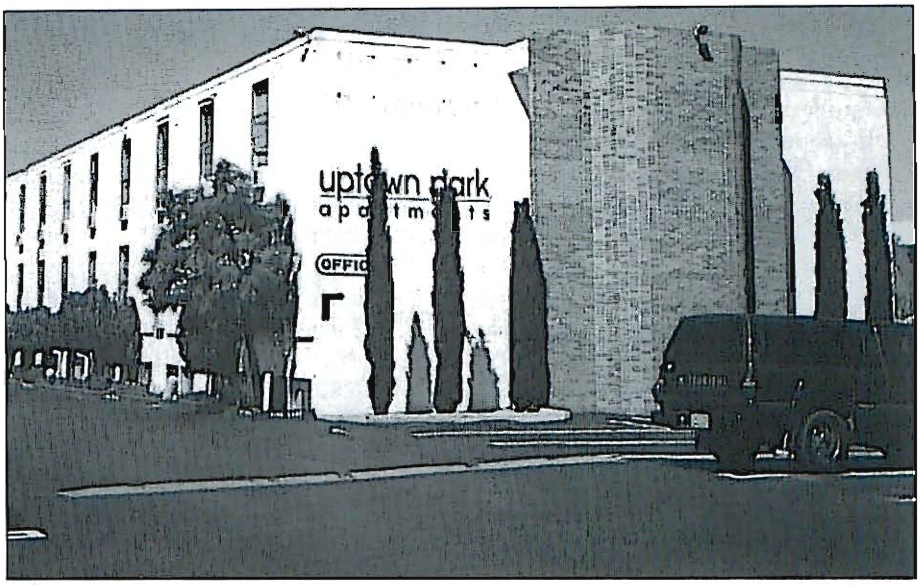
Knock on Wood

Clarke

Henderson

In 1993, Todd Clarke, CCIM, of Lewinger Hamilton, Inc., in Albuquerque, New Mexico, was working with a client who was moving from California, had $300,000 to invest from a 1031 exchange, and was looking for an apartment building—preferably one with light leverage. Clarke, who was working with John Henderson III, CCIM, keeps a database of properties (See "Success Strategies," *CIREJ*, July/August 1997) and found a variety of possibilities, including a 226-unit building in Albuquerque's Uptown central business district. The building was listed for $3.5 million, but was on the verge of foreclosure—and a $300,000 down payment could save the seller.

This wasn't the light leverage the buyer was looking for, but he was impressed enough by Clarke and Henderson's analysis to make an offer. Clarke and Henderson had developed an efficient inspection list that allows contractors to mark the condition of fixtures in each unit and estimate any repair costs. The numbers are fed into Clarke's computer system so the buyer can see aggregate repair costs and then decide how to proceed with the deal. In this case, the list contained 34 items, including termite inspection. The buyer had dealt with termites in California, where climate conditions favor the pests. On the other hand, says Clarke, they're almost unheard of in New Mexico because of the state's dry weather. The buyer decided against the inspection. "It was one of the few things he decided not to have done," Clarke says.



Several unexpected challenges hampered—but could not kill—a deal for this New Mexico apartment building.

A few weeks before closing, the quick-moving deal hit a snag: 18 parking spaces sat on a piece of land that everyone thought was being conveyed with the property. But the seller didn't actually own the strip. The city had given him a quit-claim deed, but it hadn't really owned it either—the state highway department did. The property sits about 40 feet from a freeway, and normally, says Clarke, when freeway construction is done, leftover land goes to the city. "This was a rare exception," he says. The highway department had kept the right to the piece of land in case it decided to widen the road for a ramp to the freeway someday.

Without the parking spaces, the building would have had a significant code violation, so Clarke and Henderson got the state to deed it to the city, and the city gave them a lease with unlimited duration unless the city needed the spaces. "It's not one of those things you think you'd hit in a normal deal," Clarke says.

After that, the deal proceeded smoothly. On the last day of the client's exchange, Clarke and Henderson arranged for him to sign the papers in a formal closing.

As they sat at the closing table, they got a call from the building's property manager with the dreaded words, "We have a problem." A workman who was renovating a unit noticed a wall "looked funny." He pulled off a sheet of drywall—with very little effort—and discovered why: the wall was infested with termites.

They had one afternoon to find a remedy. Henderson became "an instant termite expert," says Clarke, and they got three removal bids ranging from $8,500 to $35,000. They discussed the options with the buyer, settled on one, and by 4 p.m., had negotiated for the lender to cover the cost.

But it wasn't a done deal yet. The buyer's attorney wanted a document from the lender confirming it would pay for the extermination. The lender—in Washington, D.C.—needed to fax the document in time for the transaction to be recorded at the county clerk's office before it closed at 5 p.m. As everyone raced the clock, the closer from the title company hurried to the clerk's office and was standing by, waiting to record the document. When the buyer approved the document, he'd call the closer and tell him to record the deal.

At 4:45, as the document's cover page rolled out of Clarke's fax machine, the power went out—for the entire business district. "So it wasn't like I could walk next door and get the fax," says Clarke.

He quickly arranged to have the fax sent to another title company outside the affected area. The receptionist there read it over the phone to the client, the client approved the language, and phoned his approval to the closer, who had kept the clerk's office open. The transaction was recorded at 5:15 p.m. on the day of the buyer's exchange deadline.

Clarke sells a couple thousand apartment units every year. "And now I check them all for termites," he says. "They do exist in Albuquerque."

"Quarterbacking" Pays Off

Rosenberg

In the mid 1980s, Robert A. Rosenberg, CCIM, of Inve$tnet, Inc., in Sacramento, California, was working to create a site for a hotel that catered to business travelers in the city's South Natomas section.

The area looked promising—it was a developing business park area, located between downtown and the airport and at the intersection of two major interstates. Because the city had adopted a land-use plan that put new hotel construction at the edges of town, Rosenberg had to demonstrate the worth of putting the hotel in South Natomas; not only would the hotel be beneficial to the businesses in the immediate area, but it also would lessen traffic in and out of the area.

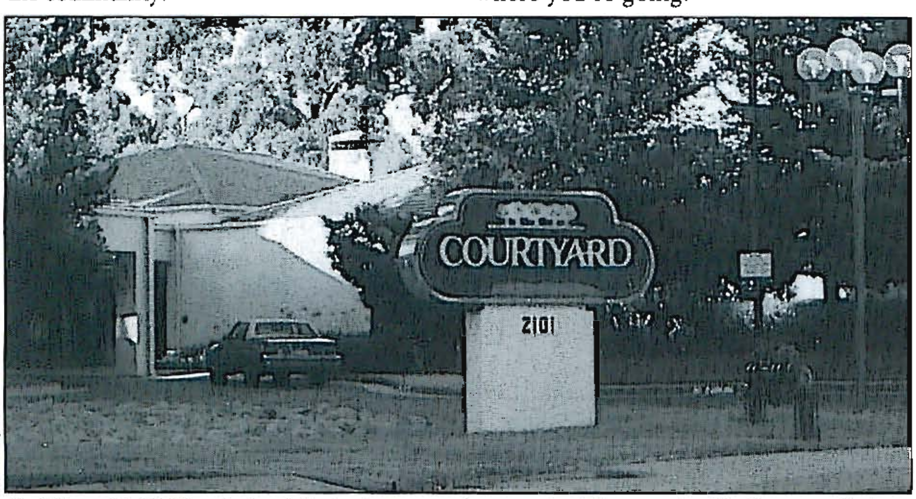
At the same time, he had to convince the seller that the city would consent to the change, as well as work with the hotel chain's complicated corporate structure, and educate a sizable, active homeowners association on why the hotel would benefit the community.

Rosenberg puts all this in the realm of "quarterbacking: translating, pulling all pieces together, getting people on the same page with the same understanding." And it began to pay off: the issues were resolved; the deal went to contract. Then Rosenberg learned that the Federal Emergency Management Association had issued new flood maps of the area—and the proposed site now was in a flood plain, changing building criteria for new construction.

Rosenberg had to negotiate a repurchase agreement in case the hotel couldn't be built. Things got complicated, though, when the chain also insisted that the developer put up a letter of credit. The developer balked, and Rosenberg started networking. He called on the chain's chief legal counsel—whom he had met informally—to reconsider the letter of credit, and the chain did.

The hotel was built at last and, says Rosenberg, has been one of the better-performing hotels in the region.

Of all the major issues in the project, the most relevant lesson, Rosenberg says, is that brokers "should know how city government process works—know what the limits are." Also, he says, it's essential to study trends on what's happening in other cities—in this case, knowing the increased number of hotels locating in business parks—and apply them to what's happening in the community you're looking at—and in South Natomas, it was the strategic location. "Don't focus on past," he says. "Focus on where you're going."



InveStnet, Inc.

Building this California hotel for business travelers required "quarterbacking" to get all the pieces in place.

A Tough Trade

Crull

Dennis Crull, CCIM, tells the tale of a 1991 equity exchange deal that involved multiple properties, multiple states, and, he says, "considerable due diligence."

In late 1991, Crull, of Timberline Investment Company in Blue Springs, Missouri, was representing a church client with a variety of properties to sell. At a marketing meeting, he met Stephen England, a broker at Investment Property Exchange in Kearney, Nebraska. England was representing a couple who owned a 1,600-acre farm near Mitchell, Nebraska, who were looking for a way to retire from farming, pay off the balance of their farm loan, and finance their retirement. The farm was valued at $650,000; $345,000 remained on its federal land bank loan.

Crull and England compiled a preliminary exchange proposal: the church would take the farm, and the couple would receive 48 properties—including rental properties, acreage, and vacant land—as well as $98,600 in cash.

Crull says he's a strong believer in counseling clients, to be sure, he says, "not only of what they want, but what they need." He put together cash-flow analyses comparing the benefits of ownership of the properties with ownership of the farm, including scenarios in which the church refinanced the loan or paid off all debts and participated in the operation of the farm as well as leasing it out.

The inspection process entailed a four-state tour in which England's client and Crull inspected and approved the properties, which were scattered throughout Iowa, Missouri, Arkansas, and Oklahoma. The inspections were successful, and the deal closed in March 1992.

Crull says the deal emphasizes the use of an equity exchange. "There are lots of people out there with equity rather than cash," he says, and a straight exchange provides them the tax benefits of an exchange without the uncertainty of a delayed exchange.

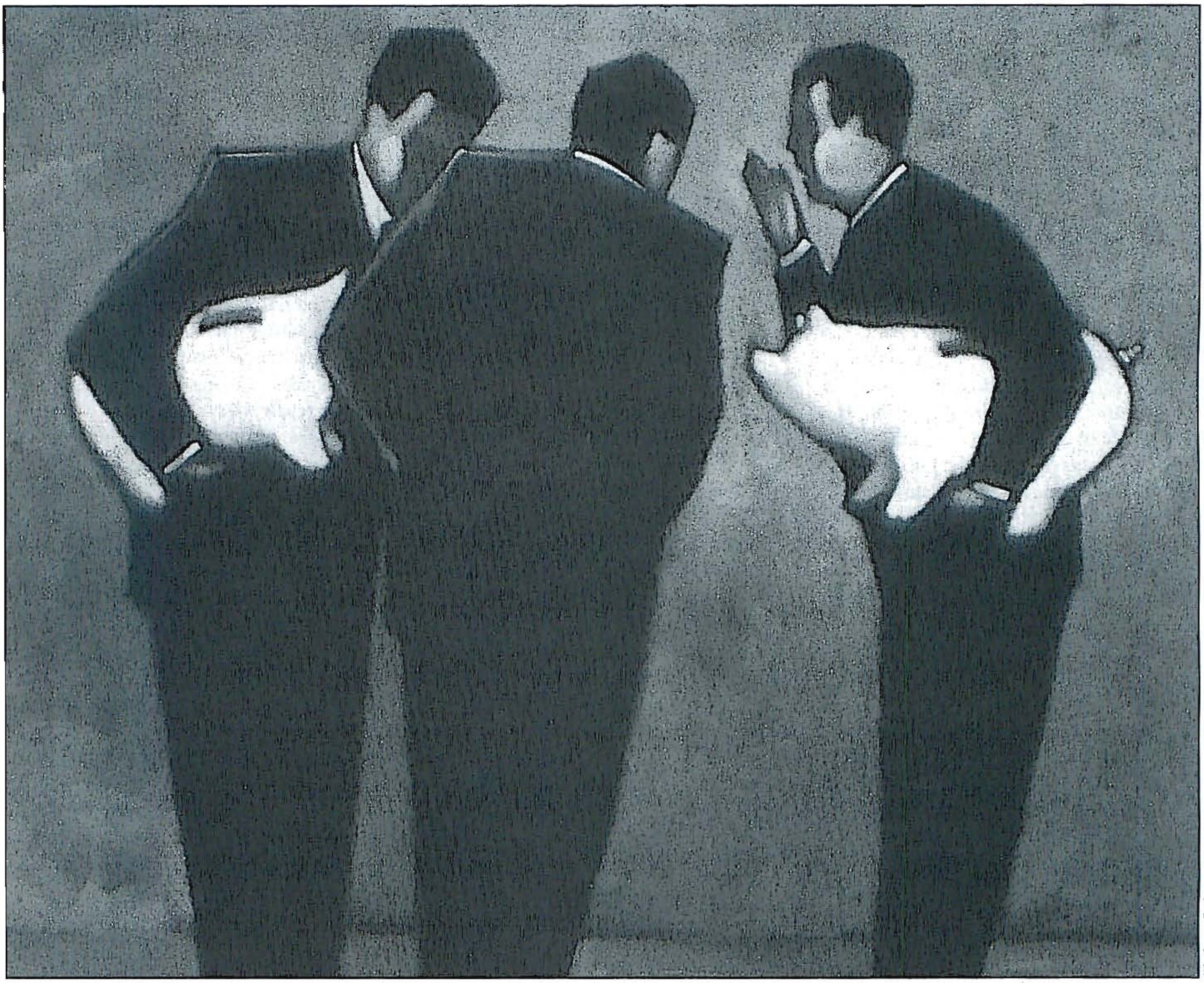
About the Author

SARAH HOBAN *is a freelance writer based in Chicago.*

Installment Sales

Use This Method to Maximize Your Tax Position.

by Donald J. Valachi, CCIM, CPA



The Image Bank

The tax advantages that investors can achieve through installment sales can help them make every penny count.

Real estate investors can maximize the use of the installment sale provisions of the Internal Revenue Code (IRC) when disposing of properties by using the wraparound mortgage when a taxpayer has a mortgage-over-basis problem; having the buyer pay the taxpayer's selling costs as a strategy to reduce the tax on the initial installment payment; and arranging installment sales for larger transactions to avoid paying interest on the deferred tax.

Under IRC Section 453(b), an installment sale is defined as the disposition of real (or personal) property by a non-dealer, provided that at least one payment is received subsequent to the taxable year in which the disposition occurs.