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Condo Meltdown

Private funds rush to buy failed conversion projects in bulk

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By: Polyana da Costa

South Florida's condo market has never been so hot. At least not from the perspective of private equity funds and investors who want to buy distressed projects at 40 percent to 50 percent discounts.

Matt Martinez

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Private equity funds are rushing to buy failed conversion projects and hundreds of unsold units in new developments in bulk.

Some funds have been able to strike deals with desperate developers grappling with mounting debts and who want a way out of a project to avoid foreclosures. But many fund managers and developers say there still is a gap between the aggressive discounts the funds are seeking and the offers developers can afford or are willing to accept.

Matt Martinez is the point-person for a Connecticut-based private equity group with a $200 million bankroll to acquire distressed condo projects in Florida. Half of the fund will be invested in South Florida projects, the rest in other areas of the state. With a debt leverage of 50 percent, the fund targets $400 million worth of properties.

"We been waiting for this [downturn in the condo market] to happen for seven years," Martinez said.

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Martinez, principal of the Miami-based private investment company Pangea Select, declined to disclose the private equity group but described it as a $2 billion firm in business for 11 years that invests in office, retail, industrial and multifamily projects.

Like other private equity investors, Martinez is looking for aggressive discounts so the properties can make economic sense as rental operations.

"For instance, we are looking at a 250-unit property in Miami in which a condo converter paid $200,000 per unit and the principal balance on the loan is $160,000 per unit," he said. "If we could buy them at $130,000, which is what it's worth on a rental basis, we would close on the deal."

He said he is negotiating with owners of 32 failed conversion projects or new developments in South Florida, including a 200-unit complex in West Palm Beach that is the only deal under contract so far.

More than a third of Martinez's prospective properties are in Palm Beach County, which has the highest apartment vacancy rate of the three South Florida counties — 10 percent, compared to 5 percent in Miami-Dade and 7 percent in Broward County, he said. The increase in the market's rental units could boost those numbers by 1 percent to 3 percent, next year, he said.

Martinez said he has also submitted two letters of intent to buy properties totaling 300 units in Broward and Miami-Dade counties. Martinez said he can't disclose the owners or properties because it would jeopardize the deals.

Martinez and his client aren't the only ones shopping for bargains. He said several times he has approached developers who say they have already been contacted by other equity investors.

Northland Investments, a Boston-based private fund manager, recently cut a profitable deal with troubled condo converter Tarragon Corp. Northland paid $21.7 million, or an average of about $86,500 per unit, for 251 unsold units at Via Lugano, a 364-unit Boynton Beach conversion project. The property was built as rentals in 1999 and converted to condos a couple years ago. Tarragon paid $74 million, or about $203,000 per unit, for the property in October 2005. Recent unit closings varied in price from $150,000 to about $300,000.

The Via Lugano sale was part of a six-property portfolio that sold for $156 million. Tarragon owed $157.1 million on the properties. The deal closed Dec. 28, according to Steve Rosenthal, Northland's chief executive officer.

"The dislocation and dysfunctionality of the real estate market has provided us with a lot of significant opportunities," Rosenthal said.

Buyback strategy

TGM Associates, a New York-based fund manager that invests in the multifamily sector, also profited from Tarragon's financial distress when it recently acquired two Jupiter projects from the company. In November, TGM bought the Floresta, an apartment/townhouse community with 311 units for $60.25 million, about 28 percent less than the $84 million Tarragon paid in January 2006.

Thomas Gochberg, managing partner of TGM, said the firm sold its entire multifamily portfolio in Florida to condo converters over the last three years when the conversion boom was taking place.

"Now we're buying it back," he said.

Gochberg said the investment advisory firm is in the apartment rental business and doesn't necessarily target failed condo or conversion projects. But about 20 percent of its purchases are properties in which the seller is in financial distress or facing foreclosure.

Although some owners and developers have sold for losses, not everyone is in a position to take the hit, especially the smaller to mid-size developers.

Isadore Cohen, owner of a conversion project near Sawgrass Mills in Sunrise, said he refuses to accept "the ridiculous offers," he has received from private equity investors.

In late 2005, Cohen paid $61.3 million for Isles at Lago Mar, a 367-unit rental complex, which he converted to condos. He has been selling the units with prices from $200,000 to $325,000.

Cohen said he has about 150 units remaining under contract, but closings are proceeding slowly due to lender delays and buyer defaults, he said. He is spending hundreds of thousands of dollars each month on the interest of the $20 million-plus balance remaining on a $49.5 million loan he took out with Corus Bank and the mezzanine lender to buy the property.

Cohen vowed he will survive the storm.

"I've been approached by brokers representing funds that require discounts of 45 to 50 percent," he said. "That's unrealistic. This is not a distressed property."

Cohen said Martinez was preparing an offer but he didn't think it would be realistic.

Expectations gap

There continues to be a big gap between the expectations of some developers and what investors are willing to pay for struggling projects, but that continues to close, said Rosendo Caveiro, senior director of apartment brokerage services at Cushman and Wakefield.

"Investors are offering 50 to 60 percent less than the asking price," he said.

Caveiro has been contacting developers, conversion owners, bankruptcy attorneys and lenders across South Florida to negotiate deals.

The interest on the discounted properties is coming from an array of investors, including private funds, former converters wanting to get back in the business, and individuals, he said.

"Owners that need to sell are still realizing they will have to take these offers," Caveiro said. "We'll be seeing a lot more of these deals in 2008."

Avery Klann, senior vice president of Boca Raton-based Apartment Realty Advisors, an investment advisory brokerage firm, also said he is working with a handful of funds looking to invest in the distressed condo market.

"It's been mostly with conversions," he said. "They are beginning to focus more and more on the new development but it's still too early."

In terms of prices, conversion projects also are more affordable than the new developments.

Whether it's a new or a converted project, investors prefer properties that are less than 50 percent sold because they want to retain control of the homeowners association.

An agent, who represents several prominent developers on the sales and marketing of their projects and did not want to be identified, said the highest discounts developers have agreed on bulk sales is 40 percent, including prior sales discounts, closing costs and commissions. The agent said only recently he has been receiving inquiries from private funds in New York and California. Their offers are very aggressive and most developers wouldn't be able to pay off their lenders if they accepted the deals.

Some vulture investors said the market has yet to reach the bottom and understand many developers are not in a position to accept the offers but that they are willing to wait to negotiate with the lenders as properties are foreclosed on.

"We have catalogued every single property that could have issues along with the lenders and we are actively watching," said Darryl W. Parmenter, president and chief executive of Miami-based Parmenter Realty Partners, which has $125 million remaining of a $250 million acquisition fund launched in 2006. The private equity firm is building a $500 to $600 million fund for next year, which would be used for condo acquisitions.

"We think it's going to be six to nine months before things get pretty ugly and we'll have a substantial amount of dry powder ready when the time comes," Parmenter said.

Polyana da Costa can be reached at pdacosta@alm.com or at (561) 820-2065.

Matt Martinez photo by A.M. Holt

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