THE REAL DEAL

JUNE 2006

Second thoughts for developers

Putting building sites back on the market; few forced to sell at a loss

By Alison Gregor

A combination of flattening condominium prices along with rising construction costs and interest rates has created a bitter pill for some residential developers, who,

SPECIAL REPORT

in an attempt to avoid swallowing it, may be trying to sell out.

Real estate brokers who handle land and building sales said they're seeing some developers, especially those who are less experienced, put undeveloped residential sites back on the market. Even sites that already have state approval are going back on the market, because novice developers are ready to get out of the game.

"We're doing valuations for about a dozen developers now that have purchased sites and are rethinking their strategies," said Robert Knakal, chairman and founding partner of Massey Knakal Realty Services. "Either it was their first development venture or their first venture in New York, and they may not have been completely conversant with the development costs or the consumer condominium market.

"I believe some of these sites will be coming to market," said

Continued on page 94

Development site resale from page 1

Knakal, which he found surprising, because last year even inexperienced developers could make a windfall on residential projects.

There are also some higher-profile cases that have raised questions. For instance, last summer, JD Carlisle Development Corporation sold the Atelier on West 42nd Street for an undisclosed sum to the Moinian Group and MacFarlane Partners, who are developing it into 478 apartments in only the first of three phases of a mixed-use development.

In the same neighborhood, the Related Companies has listed a parcel for sale at 450 West 42nd Street that could be built to 1.1 million square feet, or approximately 1,000 apartments, according to published reports. The parcel is expected to go for $300 to $400 million.

And at 400 Fifth Avenue, developer Yitzchak Tessler recently went into contract to sell a vacant site, anticipated to go for as much as $400 a square foot, that could be built to about half a million square feet along with a two-level parking garage.

Still, that doesn't mean developers are selling at a loss.

Eric Anton, a senior managing director at Eastern Consolidated, said developers with a larger portfolio can afford to sell off a parcel or two.

"We see a lot of guys who, in the crazed '03, '04, '05, bit off too much, a little more than they could chew," he said. "So maybe they have four sites, and they might want to sell one or two. They can take a small profit, reduce risk and focus on one or two or three projects they like."

David Junik, a senior director at Greiner-Maltz, said he is marketing a full block at 235 Gold Street in Downtown Brooklyn, complete with approved plans for building 410,000 square feet of space, where the developer is in just that situation.

"The developer that owns that site owns another 10 parcels," Junik said. "They believe in the location and the market, but are considering whether it pays to hold onto everything or focus on certain parcels."

The site comes with state-approved plans and that can be valuable to a potential buyer, he said. If the plans are good ones, they enable a builder to get into the ground faster, thereby reducing the interest ultimately paid on the loan. It is also a marketing advantage to finish a project before the next developer.

"This is a market where, if somebody can go into the ground now, it's part of the attraction," Junik said. It might take another eight months to a year to go through the approval process, so "for someone to go into the ground now while the market is stable is a premium to developers."

Junik said it makes sense to sell before developing if a developer can make a 20 to 25 percent return on initial investment.

Anton agreed that the time is ripe for some - particularly less experienced developers who bought property in the past couple of years - to sell the land at a profit.

"Maybe it's taken them a while to figure out what to do with it, or it took a long time to close or a long time to assemble," Anton said. "They've made a profit on the land, because land has really gone up in the last two years.

"And with today's tax rates, if you sell after holding for a year, you're treated very favorably on capital gains tax, whereas if you develop it, in condominium sales you're taxed at an ordinary income rate, so it's much higher."

What doesn't make sense in the current market, which has normalized after the frenzy of the past few years, is to sit on a recently purchased development site.

"The prices of development sites are so astronomical that even if you decided to rent your lot as a parking lot - provided you could get the permits to do so - the income you're going to generate is not enough to provide any kind of nearly satisfactory return on your investment," Knakal said. "So it's really a situation where you either build or you sell and take the loss."

Anton said he hasn't seen developers selling at a loss, though he wouldn't be surprised to see it happen. Darcy Stacom, vice chairman at the investment properties institutional group at CB Richard Ellis, said she and colleagues have had to turn away a handful of would-be developers attempting to bail from unpromising circumstances.

"We've had a number of situations where we've been called in to look, and they've paid $350 to $400 a foot for maybe a good side street site, but still a side street site," she said, "and we've just had to say, 'Sorry, unless you're prepared to get out of it exactly what you paid for it, or maybe a little bit less, we're not interested in handling it.'"

Stacom said it can be an added challenge to market sites when a developer is selling them.

"It's hard," she said. "It's definitely an additional component to the marketing effort. You've got to know that you've got a story to tell."

But Knakal said one man's poison may be another, more creative, man's meat. The typical buyer has his or her own vision for the site, even if the seller has decided the numbers won't work.

"Having that unique perspective allows people to outbid other people who look at it in a very straightforward manner," he said. "Look at what Harry Macklowe did with the GM Building. At the time he bought that, nobody else was willing to pay the $1.4 billion that he paid. But he had a very unique development plan to create additional space, to increase the bulk of the retail, to do some neat architectural things."

That means 10 different developers might look at the same site and come up with 10 different plans to maximize its potential.

"At the end of the day, it's not important why someone's selling," Junik said, "it's whether it makes sense to you." TRD

Having second thoughts about condo projects

Residential development sites placed back on the market by developers

Address	Size	Price	Seller	Previous plans
450 W. 42nd St	1.1M buildable sf site	expected to sell for $300 to $400M	The Related Companies	Related planned to build an 800-unit condo and rental project, with Cirque du Soleil taking space for a theater.
400 Fifth Ave	500,000 buildable sf site	was expected to sell for $400 per sf	Yitzchak Tessler	Tessler, who recently sold the site, had planned a 50-story condominium.
627 W. 42nd St (Atelier)	500,000 sf tower	n/a	JD Carlisle Development Corp.	JD Carlisle planned a 46-story condo on the site before selling it to the Moinian Group and MacFarlane Partners.
235 Gold St (Brooklyn)	410,000 buildable sf site	asking price $77M	n/a	The seller had plans approved for seven residential buildings.