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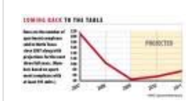
Apartment investors regain appetite

Bargain hunters funding war chests in preparation for rebound in market

Dallas Business Journal - by Bill Hethcock Staff writer



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Investors in apartment complexes are starting to regain their appetite as more bargains are being brought to the table. The current recession caused the majority of multifamily dealmakers to embark on a strict diet for the past two years.

Bostonian Investment Group, a Boston-based multifamily investment syndicator with an office in Dallas, is raising as much as $100 million for a private equity fund that will focus on buying mortgages backed by distressed multifamily properties in North Texas, said Justin Meszaros, co-principal and CEO.

From the other coast, the Los Angeles-based apartment investment company **Learning Links Centers**, which opened a Dallas office this week, is trying to raise $30 million to $40 million. Its goal: to acquire 3,000 to 3,500 apartment units in the Dallas-Fort Worth area during the next three years, including about 1,200 units in the next six to 12 months, company co-founders Joe Killinger and George Pino said.

But outsiders aren’t the only ones preparing to feast. The Dallas-based commercial real estate investment firm J Alexander Realty Group Ltd. is trying to raise about $10 million for smaller apartment complex acquisitions in the next year, said Chris Slauer, managing general partner.

Bostonian Investment Group had been an active buyer in Dallas-Fort Worth and across Texas before the recession’s full impact was felt in the Lone Star State. It acquired most of its 5,200-unit Texas portfolio between 2006 and 2008. But the acquisitions stopped late in 2008 thanks to the faltering economy and a company emphasis on stabilizing the complexes it already had acquired, Meszaros said.

Bostonian Investment Group’s only acquisition so far in 2009 closed Aug. 12, with the $8 million purchase of the Windmill Terrace Apartments, a 284-unit Class B complex in Bedford.

Meszaros expects to start acquiring apartment complexes through the new fund early next year, with an eye out specifically for properties where loans are about to mature. In the last five years, many buyers got loans based on the assumption that apartment occupancy and rents would steadily rise, he said. Instead, occupancies and rents have fallen, so properties aren’t generating the cash to allow owners to refinance, he said.

“We see the opportunities in Dallas, Austin and Houston, where buyers got into trouble overleveraging and overestimating their rent growth,” Meszaros said.

Bostonian Investment Group will focus on acquiring older, underperforming rental units, then renovating them, stabilizing or increasing the rents, then decide whether to dispose of or hold the property, Meszaros said. Bostonian will look for complexes in the $5 million to $20 million range, and will aim to buy the notes on the properties for 50 cents to 60 cents on the dollar, he said.

Apartment transaction volume peaked in the Dallas-Fort Worth area in 2007, when 211 apartment complexes of 101 units or more changed hands, said Brian O’Boyle, managing broker of the Dallas office of Atlanta-based **Apartment Realty Advisors**.

Transactions in that category fell by half, to 105, in 2008, and only 31 complexes of 101 units or more have sold so far this year, said O’Boyle, who specializes in brokering multifamily projects.

O’Boyle projected the Dallas-Fort Worth area will have 45 apartment transactions this year, 55 deals in 2010 and 75 deals of 101 units or more in 2011.

O’Boyle sees others, such as the Bostonian Investment Group, being well-positioned to pick up bargains in the multifamily sector.

“A lot of funds are raising equity now to take advantage of some of the opportunities that will be in the marketplace,” he said. “Long-term, people see Dallas as a market that will have considerable upside in the future.”

Timing is right

Like Bostonian, Learning Links will look for older fixer-uppers where it can stabilize the property and increase occupancy and rents, Killinger said.

North Texas’ pro-business climate, especially in regard to job creation, and the fact that multifamily real estate values didn’t escalate as quickly here as they did in places such as California, make the area an attractive place in which to invest, Pino said.

“We always felt like the Dallas-Fort Worth Metroplex had a much stronger chance to weather the economic downturn than any other area of the country,” he said.

Now is a good time for companies to raise funds to start buying distressed apartment complexes and notes of distressed assets, said Charles Williams, managing director of Mansfield-based **Pioneer Services** LLC, a commercial mortgage intermediary with a heavy focus on the multifamily sector.

“Many banks are under pressure by the FDIC to get these nonperforming assets off of their balance sheets,” Williams said. “It’s a great deal for the note buyer because he’s going to be able to buy that note at a significant discount.”

Williams said multifamily properties already have touched bottom in some areas of the country, but in Texas the best deals on distressed rental properties will occur next year.

“I think we’re going to be at the bottom in about six months, and there will be a feeding frenzy at that time,” he said. “That’s when you’re going to see the real deals and values.”

J Alexander Realty Group Ltd., the Dallas-based firm, has shifted its focus from development deals to apartment complex acquisitions during the past two years, Slauer said.

There’s still too much difference between asking prices and the prices investors are willing to pay for multifamily properties, he said. When that gap starts to close, more sales will start happening, Slauer said.

“It’s a cat and mouse game right now,” he said. “They still want to sell at 75 to 80 cents on the dollar, and we’re trying to buy at 50 to 60 cents on the dollar. When that delta shrinks, you’re going to see a lot of deals.”

Many out-of-state investors, especially Californians, bought North Texas multifamily properties sight-unseen in the past three to five years and overpaid by 20% to 30% or more, adding to the out-of-whack expectations, Slauer said.

Even though Texas was one of the last states to be affected, the recession has hit here and the apartment market will feel the effects for the next 12 to 18 months, said Will Balthrope, vice president of investments for the Balthrope Group of Marcus & Millichap Real Estate Investment Services. Rents will erode and vacancy will increase until the area quits losing jobs, he said.

Apartment occupancy and rents are falling in North Texas at the same time that Dallas is set to deliver more units than anywhere else in the country, according to apartment market analysts MPF Research.

After holding steady in late 2008 and early 2009, effective rents fell 1.7% during the second quarter of this year. Mid-2009 rents also were 1.7% below their June 2008 levels. The average apartment rent across the Dallas-Fort Worth area in June was $753 per month, the MPF research shows.

The occupancy rate for North Texas apartments was 90% as of June. Occupancy dropped half of a percentage point during the second quarter, making the decline a full 3% for the year ending in June.

MPF is forecasting rent and occupancy declines through the end of 2010, said Greg Willett, MPF’s vice president of research.

“Occupancy and rents are both headed downward, so revenue has taken a pretty significant hit,” Willett said. “But’s what’s leading to some sales is the fact that you have maturing debt and people can’t get that refinanced.

“Conditions are continuing to deteriorate, and I think that’s pushing more assets to the distressed category. Sales are going to be focusing on assets that have gotten into trouble.”

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