Salvaged deals can become the rule, not the exception in the world of affordable housing

April 18, 2013 - Connecticut

In the world of affordable housing, when deals crumble they leave quite a mess in their wake. Investors, lenders, property owners, government agencies, real estate professionals and, most significantly, affordable housing residents are all affected by the fallout. In this era of Sequestration, when shrinking purse strings make the financing of new affordable housing more difficult, broken deals further erode confidence in this market segment.

Given that our nation currently faces a shortfall of about 5.5 million affordable housing units, we cannot endure too many fractured deals, and having them become par for the course is simply unacceptable.

They don't have to be. According to Vesta's research, analysis and experience, almost every troubled deal can be salvaged before it breaks apart. Every deal that begins to unravel can be put back together. Every deal that gets shelved can be restructured.

In most cases, no single person or entity is responsible for the breakdown of a deal. All parties involved must do the proper homework before becoming involved in the transaction. When a deal breaks, it is often because more than one participant has erred in their analysis. Fixing the deal will require that all participants contribute to the solution. It is often not easy to accept that responsibility when mired in the rubble of a broken deal. When participants become adversarial as a result, it is time to accept the reality that you may have to partner with someone who knows how to restructure the deal a little better than you, or can better communicate with the other participants.

A deal starts with a purchase contact, and anyone wishing to explore an affordable housing purchase should never step into the contract phase without the opportunity to complete comprehensive due diligence. It is then imperative to undertake an efficient due diligence process within the time allowed. That's why Vesta, as an example, includes an extensive network of experienced attorneys, accountants, and third party specialists as part of its team. It's a team that is able to assess all risk factors (both for our own purchases and for those of our partners) and make the proper decisions that help to avoid or overcome the inevitable obstacles to closing a deal.

Due diligence includes research into rental income, the various types of federal, state, and local financing that are available, the condition of the property, construction redevelopment costs, local political and public support, and more. It's a large, complex list to be sure - but no one ever said that affordable housing is a real estate niche geared for newcomers or amateurs. It most certainly is not. It's a serious, demanding business, and because of the residents who it is geared to benefit, it is also a vitally important business. Many firms simply cannot handle the gravity and intricacy of what's involved to do it right. I'm pleased to report that Vesta isn't one of them. Quite the contrary: our principals have closed financings approaching $1 billion in 12 states and Washington, D.C. That's why a growing number of firms are eager to bring us aboard as a partner for financing and development.

We have found that "over-leverage" is a common cause for deals breaking down. (This is not always a function of shortsightedness, but may be due to an economic downturn.) Often there is a perfect storm of too much debt accompanied by a decrease in rental income, which results in a choice of paying the mortgage or paying operating costs. The choice of paying the mortgage and cutting back on maintenance is only a stopgap measure. Before too long, deteriorating conditions result in lower occupancy and lower rents, the further steps in a downward spiral leading to a broken deal.

Other factors undermining many deals include substantial cost overruns, schedule delays, and new data that indicate how rental income will cease to meet revenue targets. Put plainly and simply, this represents financial and project mismanagement. At this stage the solution involves analyzing what level of capital investment is needed and what a restructuring of the financing could generate long-term value.

Again - not a simple process, but not an unachievable one, either.

When a property is deemed unfit to attract quality tenants, some potential owners or investors panic or just give up. That's not necessary. There are many methods available to improve the outlook, such as adding support services and doing community outreach. Such methods are cost efficient and often work well toward repositioning a property to make it more attractive.

As noted, fixing deals in which potential buyers start to head for the exit ramp often require taking on an experienced partner. As long as the partner is strong, smart and resilient, and as long as all the past, present, and future assets and liabilities of the total deal are transparent, then confidence can be restored. Troubled deals will be rescued and unraveled deals will be rewound. Fresh and more agreeable terms and conditions will usually be offered and accepted; after all, everyone who is coming to the table is doing so with the expectation of completing a deal.

How do we know all this? Because we've been doing it. Our business is to purchase distressed affordable housing and turn them around. By 2016 we will have doubled our portfolio of 4,200 units. We currently operate in Connecticut, New Jersey, Ohio, Indiana and Washington, D.C., and we welcome geographic expansion, as well as properties that are quickly aging and are in distress. Our financial stability and the stability of our partners may be extremely important, but in the world of affordable housing, the safety, satisfaction, and optimism of the residents who live in our properties is the real measure of success.

Margo Kelleher is vice president, development of Vesta Corporation, Weatogue, Conn.