URBAN RENEWAL: UPGRADING COMMUNITIES

By Martin V. Lavin

The wrecking ball dropped on the old 4- to 5-story tenement buildings and those dark stained bricks, standing since the 1870s came tumbling down. I was still a child as this happened in my hometown of Barre, Vt. Barre was hardly unique as this was occurring through much of the nation in the '50s and '60s.

It was called "urban renewal" and it used federal, state and local funds to take down obsolete residential and commercial buildings to return the site back to raw land and be reused for a "higher and better" use.

The process was hardly without its detractors. Many viewed it as simply bulldozing neighborhoods. There were questionable episodes of unjustified razzings and some urban damage was sustained. In addition, much of the land was still in deep, urban locations and all of the forces leading to much of the city problems of today were in full germination even by then. Urban renewal was not easy and in some cases achieved little. In others, it worked very well.

Last spring, I was with my personal doctor and friend and we were chatting real estate. We jointly owned a 112-unit apartment complex for several years in the '80s and '90s and he was reviewing his plans. He was going to level the buildings to reproduce the 112 apartments and create another 50 as well. The latter was a zoning bonus by the community for a new complex where new, entry-level housing is badly needed.

We talked about our changing perceptions of the role and useful life of an apartment complex, its residual value and the absolute need to spend substantial sums of money every five to 10 years to keep it fresh. We also talked about how in about 25 to 30 years the building might actually have to be cleared away for new construction, as he was now contemplating.

That naïve belief we had when we purchased the complex that we would pay the property off as quickly as possible and live off the income stream came up against the realities of modern building codes, resident expectations, competition and the reasonable life of modern building materials, to say nothing of the rapidity with which location desirability can change as areas evolve.

While on a consulting assignment, I was looking at 11 factory-built home communities in an industrialized northern state. The oldest community was built in the '40s with the most modern from the '60s. All of them were in extremely desirable cities and locations.

Most of the homes are narrow, very elderly single-section homes. The streets, landscaping, signage and road overall appearance are less than desirable. The owner is searching for answers and wants to approach what he believes is a refurbishment program to protect and enhance his investment.

What do these three anecdotes tell us and how are they interwoven? The most obvious answer is structures and its amenities, utilities and location change over time, and not always for the better. Buildings that were new and shiny in the 1960s are drab and well used by the 2000s. Even if they had been well maintained and refurbished, age and normal wear slowly brought their condition down.

Nothing lasts forever

Private property owners have been improving and refurbishing buildings for centuries. With the longevity of

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the monumental building materials of the past, they could last for a very long time. But, as modern building materials with dimensional lumber and designed loads were constructed, the ease and cost effectiveness of construction replaced the lengthy lives expected of many structures. To say nothing of changes brought about by modern mobility, compliments of the automobile and the rapidly changing character of neighborhoods.

As neighborhoods age, they often attract less affluent people, who spend less on the buildings, causing even greater decay, leading to a downward spiral.

Post World War II, the government was seeking ways to stop the blight and recycle what had once been valuable land. Urban Renewal was an answer to putting new life into the old land. Even with all its problems and costs, the result was positive even if it did not meet all the promises and expectations.

Today, about 50 years after the “mobile home parks” of the ’50s and ’60s, many of the very same considerations and challenges sustained by all other property types are now staring owners of today’s factory-built housing communities square on.

How can a community owner, with or without government and regulatory authorities cost effectively prompt a beneficial change in their community without the terrorizing tactics of wholesale dislocations of residents through forceful evictions? The process is not easy, to say nothing of the substantial capital costs necessary for the transformation.

The first adjustment that must be made is the same one my doctor friend had to make to cope with the realities of his apartment complex: You are unlikely to ever pay them off. While your goal may have been to pay the mortgage and live off the income stream or sell the community and live off the proceeds, that has to be tempered. It is not a surety.

Whether you are allowing the community to slip into obsolescence and keeping all the money you should be re-investing in the asset or continually re-investing in the asset and upgrading it, you are unlikely to see all the cash you envisioned the day you purchased it.

The danger, of course, is that you drain so much money from the community to pay mortgages, operating costs and yourself, that you wait too long to play catch-up. By then, a glut of older homes, rutted streets, tangled landscaping and lowered desirability will have brought about a marginalized property appealing only to residents with low affluence. At this point, absent substantial and expensive changes, the property will be in a death roll, even if it is a slow one.

Pressure will come from the much greater management responsibilities resulting from residents with poor jobs and life pathologies. Payment history will be poor, lost rents will increase, vacancies will increase and rent increases will slow. These are all bad for landlords.

Then, as your property reaches “eye-sore” dimensions, government induced regulatory pressure will arise. It will start with more scrutiny, followed by reduced cooperation, ending in a battle to force you out. This doesn’t always happen, but is the likely transition.

Exit strategies?

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THE BIG PICTURE

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One solution is to sell the property. Your return will be low and financing the buyer will be difficult. If you take back paper on the loan, don't be surprised by payment difficulties. If you don't sell, all you are left with is the same eventual course as the cities were faced with: urban renewal. You will work hard to fix the community's problems and like apartment owners, you will have to finance the improvements, making it difficult to pay off and own it free and clear. Or worse, you will have to reach back into your pocket and come up with substantial capital for the improvements.

Improvements such as signage, roads, landscaping and others will be costly, but easy. In most cases, they are a matter of local approval and will be highly beneficial. It will start the change in philosophy that in this community you are not going to allow "the bad to drive out the good."

The real difficulty will be changing the homes themselves. Remember, even a very old, very small, very decrepit home constitutes a dwelling unit and will be sought by someone, most often by someone you don't want. That means as these homes come up for resale (85 to 90 percent will every 10 years), you should buy them if you do not want them in your community.

This is the only way of completing your private urban renewal—remove the obsolete home and replace it with a new one. Or, work with someone who will do the same. This is the least offensive manner to upgrade the homes themselves, but it's a slow process and will take many years. And, about the time the transition occurs, you'll have to start over again. The process never ends in most communities.

Sometimes, the challenge in older communities is the lot size is not adequate for many of the new homes. This has been well voiced by community owners and the subject of on-going conversations with the factories building new homes. For many of the older, densely sited communities, the small lots have really complicated the owner's urban renewal possibilities.

This leaves few alternatives, none of them particularly attractive. The first is to use "Park Model" homes, which are really glorified RVs, generally expensive on a square foot basis, not as easy to finance as a primary residence and quite small. However, they are attractive, readily available and popular with retirees.

The second option is to downsize the number of homes and combine two or more sites into one capable of accommodating one of today's more desirable homes. Obviously, this runs into the problem that all of the sites need to be empty at the same time and you are unlikely to recoup as much rent from one large site as you do from two or more small ones.

In more extreme cases, whole communities or significant portions are emptied through mass evictions and a whole new redevelopment effort employed. This can lead to the same troubling criticisms heaped on the government when they do it and generally gives this industry one more black eye in the process. If you resort to this approach, make sure you have thick skin and a good lawyer.

Make no mistake, all of these methods can be expensive, difficult and controversial, but every community will have to go through it. The trend isn't industry-wide yet, although many community owners already have and continue to be involved in their own upgrade project. But as I travel the country and review community listings, I still see a very high and seemingly increasing number of obsolete communities every year.

Many of these have fallen so far that urban renewal won't help. Some will descend into "apartments" which are rented by the week. This practice is not for everyone, as it creates all the downsides of factory-built home communities and low-end apartments in the same package.

Other communities limp along, vacancies increasing as residents become scarce, ultimately comprised of older, inexpensive homes, a candidate for closing and transition to a higher and better land use. Ownership, unaware of the realities until he or she attempts to sell the community, is hit with a crushing force by the facts.

The apartment guys found out long ago that substantial amounts of their annual cash flow needed to be directed at property improvement and enhancement. Periodically, even larger sums are required to keep the property at the condition level residents demand or face severe image downgrade. Over time, image and condition impact income stream and the value of the property. In this industry, realization really seems to have been slow to arrive. Ignored long enough, poor image and condition will undermine the value of your investment, just as it does with all other property types.

The final danger of your community falling into decrepitude is the burgeoning trend towards a community rating system. The rating system for communities has been on the stove for a while, but mostly backburnered. Conversations with retail lenders reveal they now want to know the condition and type of community where their collateral will be placed. As the community condition is found to be lacking, this could adversely affect the advance amount on the loan, interest rate and even whether financing will be readily available.

This will impact the type of home coming into your community, the financial capability of your incoming residents and the value of the homes in there as well. These impacts all have consequences, mostly bad, for marginal, low-rated communities.

It becomes more obvious daily that marginal and obsolete communities have many challenges ahead. Left unresolved, these conditions are likely to torpedo the investment. If you are in this situation I suggest drawing up plans for improvement. Failure to do so can and will be hazardous to your financial health. And if you haven't had an attitude adjustment about what you need to do on an ongoing basis to enhance and preserve your investment, expect the worst. ■

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