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Revitalization no small challenge

Lenders seeking to limit risks on residential redevelopments

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Developer Hart Mallin, in front of a Princess Street redevelopment, says lenders are requiring developers to jump through more hoops than they did in the past.

They're sprinkled throughout the downtown -- tired old office buildings and warehouses that are crying out for redevelopment.

And judging from the rapid take-up on the city-provincial residential development grants program, there are plenty of developers out there who are eager to take up the challenge.

But as some of the developers who have been down that rocky road will tell you, these revitalization projects are not easy to tackle. It takes a lot of money, a lot of patience, and nerves of steel to make them work. Especially when it involves a government-designated heritage building.

Obtaining financing has also become more challenging, according to the lawyer/developer behind a controversial proposal to redevelop the vacant St. Charles Hotel on Notre Dame Avenue into a boutique hotel.

"There is financing available through banks, mortgage companies and other lenders," Ken Zaifman said in an interview.

"But I think lenders are being a bit more prudent. They want the owner or developer to have more of a stake (in the project), to put in more money," he said. "They're looking to minimize their risk somewhat."

Zaifman and local entrepreneur Daren Jorgenson, who wants to redevelop the nearby Royal Albert Arms hotel on Albert Street, have both come under fire recently from the city for taking too long to get their projects underway. And both have cited challenges in obtaining financing as part of the reason for the delay.

Hart Mallin, another local developer who has been involved in five or six such projects over the last 10 years, said lenders are also requiring developers to jump through more hoops now than a decade ago when he tackled his first redevelopment project.

Mallin attributes that to experience, and the fact lenders have become more knowledgeable about the potential risks associated with these projects. And they're taking steps to reduce their exposure to those risks.

For example, the developer and the anchor tenant in a commercial redevelopment usually each have their own architect to oversee the project and make sure the work is being done according to plan. But now many lenders are also insisting that a third, independent party be hired to review the work as well before any money is paid out to the contractors.

They're also demanding an environmental assessment to ensure there are no hidden dangers on the property -- things like lead pipes or asbestos insulation. And when a building is being converted to a different use, they want proof of civic zoning approval and that the existing water and sewer lines are adequate.

But more than anything, they want assurances the revitalized property will generate enough income to cover the mortgage payments.

"There's no intrinsic value in real estate unless it's producing income," Mallin said. "That's how you pay back your loan."

Mark Hofer, who has redeveloped three century-old downtown buildings, including the Avenue and Hample buildings on Portage Avenue, agrees.

"It (whether you get financing or not) is always based on cash flow," he said. If there's not enough cash flow, you likely won't get the loan.

And that's the way it should be, he added, noting the 2008/09 financial crisis in the United States was triggered by a real estate market crash and too many bad mortgage loans.

Mallin said most lenders also want assurances the developer has enough equity to cover any "surprise" costs that might arise. Some even insist the developer pay for the initial demolition work himself.

Once the interior walls have been removed and the original plumbing, insulation and electrical wiring have been exposed, they can get a better idea of what the redevelopment costs are likely to be.

Mallin said lenders also like it if you can obtain a government grant to help offset some of the redevelopment costs. They view it as additional equity for the project.

Zaifman said he'd also like to see governments provide additional funding for heritage buildings, which are more costly to redevelop because the building's historical character must be maintained.

"To maintain the facade and work around it is a significant cost, and it's not like you can derive a significant amount more revenue by doing it," he said. "At some point in time, someone has to say, 'We're prepared to put some resources towards that.' "

The city-provincial downtown residential development grants are designed to encourage more residential development downtown. Under that program, extra taxes triggered by property reassessment are returned to the developers as a grant. They can get up to $40,000 for each new apartment or condominium they build.

The first $20 million allocated for the program in 2010 was supposed to last three years, but was gobbled up in less than 10 months. And most of the second $20-million installment approved last year has also been allocated.

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