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Apartment Renovation Opportunities to Increase with Transaction Volume

Attention to deferred maintenance is the first step in larger value-add plays.

By: [Chris Wood](#)



Miami Beach-based Fifteen Group will hit deferred maintenance first, value-add rehab next at the Turtle Creek Apartments in Naples, Fla.

Credit: Fifteen Group

Common to several apartment acquisitions announced during the month of October has been the intention of new owners to immediately invest in capital improvements to enhance their properties' competitive advantage. Whether those investments are simply the execution of deferred maintenance or are true value-add rehab plays depends largely on market locale, asset type, and the distress level of the seller. Nevertheless, apartment rehab specialists are finding current work—and the prospect of exponentially increased business—much to their liking as apartment operators start fixing things up.

“Based on our experience in California markets, we believe there is only a small percentage of multifamily properties that do not need some level of renovation in the near future, or that could not benefit from value-add improvements, such as unit interior renovations,” says William Brooks, president of Walnut Creek, Calif.-based Sequoia Equities, a multifamily owner/operator that recently launched Sequoia Property Services, a division that offers value-add consultative and construction services to apartment owners. Brooks expects multifamily renovations over the next several years to be budgeted in a range of \$10,000 to \$50,000 per unit, with \$15,000 to

\$20,000 per unit being a likely market median.

That matches up with Texas rehabs being conducted for Los Angeles-based Post Investment Group by Austin-based Seven Hills Commercial, which will provide substantial renovation services—including demolition, mold and asbestos abatement, and complete interior unit rehabs—for approximately \$11,000 per door at properties in Austin and Houston.

Renovators are quick to draw a distinction between large-scale value-add rehabs and deferred maintenance, however. While both are accretive to NOI, execution of deferred maintenance is still seen as a step to merely reach market rents.

Comparatively, value-add is a way to push a premium on market rents via cap-ex investments. “Deferred maintenance is not the new value-add because in and of itself it does not present the opportunity for rent uplift,” says Ian Sanders, principal of Miami Beach-based Fifteen Group, which is in the process of repositioning the 268-unit Turtle Creek Apartments complex in Naples, Fla., via extensive physical upgrades. “Usually deferred maintenance it is an indication of other things going wrong. Whether due to overleveraged financing or some other type of distress, when an owner needs to manage cash, the property typically gets bled.”

Brooks agrees, and says that Sequoia counsels clients to minimize deferred maintenance regardless of the economic cycle and focus on value-add in advance of expected fundamental improvements. Nevertheless, Sequoia has been able to recognize some value-add rent uplift even in the face of deteriorating market rents.

“We continued with some renovation projects right through the teeth of the recession, and we have seen positive rental revenue trends on each of these properties when comparing the peak of the last cycle to the trough,” he says. “For example, we recently completed a \$24,000 per unit renovation on our Tower 737 property in San Francisco. Effective rents in the most recently-completed quarter were nearly 4 percent higher than in the same quarter of 2008. Given that overall San Francisco market rents dropped nearly 6 percent in 2009, we consider this to be an extraordinary result, and believe the potential exists in other markets as well.”

Sanders characterizes value-add opportunities in the current economic climate to be “situational,” counseling that operators interested in serious rehabs include that in their underwriting from the start, or engage specialists for assistance. “People are understandably wary of value-add transactions in markets that are still burning off concessions,” he says. “You have to know your property and know the submarkets to know what the asset can handle. Value-add operating in this market is a lot different than operating in an up market where you are raising rents anyway.”

As apartment transaction volumes and rent fundamentals increase, Brooks says value-add will come back in a big way. “Given current cap rates, and upcoming maturities in securitized loans, we believe transaction volume and accompany renovation opportunities will be increasing significantly in this timeframe.”

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