American Banker

The Only Daily Banking Newspaper

VOL. CXLV, No. 87 | Monday, May 5, 1980 | 144th Year | $1.50

Real Estate Finance

Benefits Abound from Developer, Lender, Community Partnerships

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The startling shifts in the U.S. economy over the past several years are bringing dramatic and fundamental changes in the way urban real estate will be developed and financed in the future.

Once, developers could count on an endless supply of easy mortgages from a wide variety of sources for just about any type of project they had in mind. Today, mortgage financing has withered drastically, thanks to the energy crisis, soaring inflation and prohibitive interest rates, and real estate developers are now hard-pressed to find money from any source at any price.

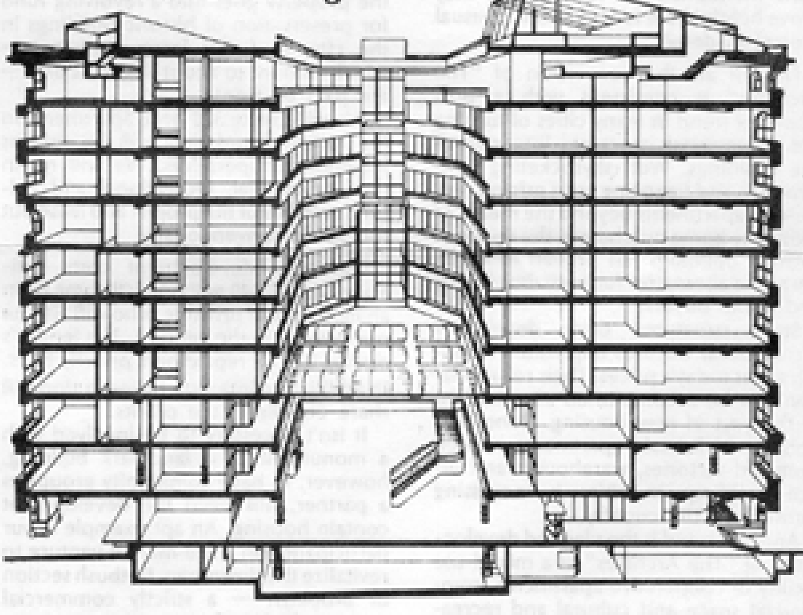
Dismayed by skyrocketing construction costs and prodded by the government to restrict credit, lenders today have become less and less interested in putting their money into traditional real estate relationships. A 13% return on debt is just not attractive in inflationary times. Neither is locking up money for 30 or 40 years on speculative deals when there is little confidence that market interest rates will remain stable.

Thus, banks and thrift institutions have begun to rethink their role in the development scheme. More and more are coming to the conclusion that the only way in which they can viably participate under today's changed economic conditions is to become a full-fledged partner in the development process.

In increasing numbers, financial institutions have begun joint-venturing urban development projects of all kinds. They are seeking out those successful developers who have the capabilities to guarantee completion, performance and price. And they are benefitting from the equities in a project, not just the return on its debt.

These institutions are finding distinct advantages in such a relationship. For one thing, the financial benefits are substantial; in addition to interest, the lender splits the profits 50-50 with the developer. For another, since lenders are forming these ventures with only the more substantial builder/developers, they are helping to ensure that their investment stands the best chance of paying off.

Moreover, lender money in such a relationship is tied up for a relatively short period — usually, no more than three years. And since the developer more often than not is required to front-end the initial costs, the lender is not really putting up anything at first except a commitment to provide money.



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The impact of such a partnership on the building community will become even more apparent as the decade progresses. Small builders, increasingly shut out of the developer/lender partnership, will have to rely on the credit and track record of a large builder and become, in effect, a subsidiary of a big developmental firm. The large builders, in turn, will spin off joint ventures with small, regional development concerns. Thus a whole series of inter-related partnerships will emanate from the new developer/lender arrangement.

This trend in America has just begun, although Europeans have done business this way for years. It will be the classic business shake-out; the strong will survive and the weak will disappear or align themselves with those better equipped to carry on.

Today's developer and lender must be prepared to make room for still another addition to their partnership. Recently, we've seen the emergence of the community as an active participant in urban developmental efforts. Government is not merely supplying incentives for