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What does it take to build a condo?

While few are doing it, some daring real estate souls are revising costs and starting projects

By David Jones

While the pipeline for condos has slowed to a near-stop, there are a few daring developers out there picking up land and buildings in this tough market.

But those who are making purchases and starting up projects now are doing so with revised cost projections — faced with the reality that expenses must be contained in a weak sales market.

The Related Companies, for example, restarted construction in the fall on a long-delayed skyscraper at 440 West 42nd Street, which includes a Frank Gehry-designed theater, a hotel and 800 apartments — a mix of market-rate rentals, affordable units and condos.

The deal was made possible with the help of $25 million from the city for the theater and a citywide agreement between developers and more than 40 labor unions to trim construction costs up to 20 percent. The project had been on hold for months amid the downturn and limited financing.

"This development was unique in that the foundation work had been completed and the financing was in place, but it offers valuable lessons that can be applied to future projects on how we reduce the price of construction in New York," Bruce Beal, executive vice president of Related, said when construction restarted.

Left, a rendering of Related's project at 440 West 42nd Street. Above, Stephen Ross, the company's CEO.

Dan Fasulo, managing director of research at Real Capital Analytics, estimated that the deal will allow Related, which is run by Stephen Ross, to build for $500 to $600 a square foot, possibly setting a new low benchmark for residential construction in Manhattan. The $800 million project was originally projected to cost about $1 billion.

"A lot of contractors aren't as busy as they used to be and certainly are going to adjust their pricing to take into account current market conditions," said Fasulo.

A limited number of other projects have also been announced in recent months.

For example, Durst Fetner Residential — a joint venture between the Durst Organization and Sidney Fetner Associates — closed a deal in September to buy 1212 Fifth Avenue from Mt. Sinai Hospital for $42 million, or $350 a square foot. The firm plans to convert the 16-story building into condos. Durst Fetner officials were not available for comment.

A joint venture of the Durst Organization and Sidney Fetner Associates bought 1212 Fifth Avenue, below right, for $42 million. Above, Douglas Durst, chairman of the Durst Organization.

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>
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And in a very public deal in August, developer Young Woo acquired American International Group's 70 Pine Street and 72 Wall Street office towers for a combined $150 million, or about $105 a square foot, with plans to convert 70 Pine into a mixed-use property with condominiums. By comparison, the nearby 26 Broadway sold for $375 a square foot a few years ago.

Woo has estimated capital costs of $50 per square foot and tenant improvement costs of $70 per square foot in the building's commercial space. He has not publicly disclosed how much he plans to spend on renovation costs on the residential side. But his claim that he will be able to sell condos at $2,000 a square foot has raised more than a few eyebrows, as the top conversions in the city are struggling to reach that price point.

Analysts said there are several factors developers will need to overcome if they are initiating projects in this market.

First, they will need to have acquired land at a lower price point to develop new condos at a reasonable cost. "You would have to have the land banked at a price level that was well before boom time," said Fasulo.

But many new developers own their land at inflated prices. When the market was soaring, the cost to purchase land topped $400 per square foot in Manhattan, and that was before a nickel was spent on actual construction. A lot of developers locked in at those high prices as they rushed to purchase empty lots before the June 2008 expiration of the city's 421-a tax abatement program.

Even those who purchased land for reasonable prices today face other obstacles.

"There's almost no construction financing available," said Shimon Shkury, a partner at Massey Knakal. "If there is construction financing, it's really minimal, full recourse, and at a high interest rate."

Lenders are also demanding that developers come up with additional equity for budget overruns and are calling in technical defaults if a developer fails to pay the contractors.

"Basically you have to swallow your medicine," said Jeff Levine, chairman of Levine Builders and Douglaston Development, the sponsor of the Edge, a 575-unit luxury condo in Williamsburg.

Once one of the city's hottest emerging markets, Williamsburg has seen a dramatic fall in sales.

Levine said at the height of the boom, construction costs ran about $400 to $450 per square foot, and are down as much as 25 percent. Land costs, which can vary depending on location, are down from about $200 a square foot in Brooklyn to about $75 a square foot in some cases.

Some developers are pushing forward with high-end condos, betting that the market will rebound by the time their projects start sales. DDG Partners bought the vacant land at 41 Bond Street for just over $9 million in September and is now planning to spend approximately $25 million more on construction (see related story on page 30).

Those projects that are already under construction and that will come online before any rebound can expect higher marketing costs, according to Oliver Sohn, a partner at 7th Art Real Estate, a Manhattan-based marketing specialist. His firm has developed marketing campaigns for several condos in New York, including the Charles at 405 East 75th Street, and the Plaza.

During the boom, marketing costs averaged 2 percent of the anticipated sales price, according to Sohn. A project would have to generate 100 qualified sales leads to close between three and five contracts. Now developers need to generate up to 200 qualified leads to close the same number of deals.

"Since traffic and, thus, leads are driven by marketing, developers are faced with the decision to upgrade their marketing costs per square foot from 2 percent to about 3 percent," said Sohn.

While not newly opened, the Fairchild, a 21-unit townhouse and loft building in Tribeca, is seeing those higher marketing costs. After years of community opposition and regulatory review, the $55 million development at 55 Vestry Street began sales in November 2008, right after Lehman Brothers fell.

An investment group that included "Sopranos" actor James Gandolfini and developer Gerard Longo acquired a landmarked site in 2005 and developed plans for two residential projects, called the Fairchild and the Pearline Soap Factory.

The project was forced to slash asking prices — which run $1.96 million for a two-bedroom unit up to $23 million for a 10,000-square-foot penthouse, according to StreetEasy — by up to 20 percent last year. There were no recorded sales by the middle of last month, but 13 units were in contract, according to StreetEasy.

Longo said the soft costs, including the monthly interest payments to the lender and staff and marketing expenses, have been a bigger drag on the property than the hard construction costs.

"The hit was not because of hard costs. The hit was because [we still have to pay] soft costs," said Longo. "So yes, we made adjustments on our expectations. We think because we do have a quality product, that is allowing us to get through this market." TRD