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Dominium seizing opportunities in Sun Belt

by Mark Anderson

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Developer/investor increases multifamily holdings by 65%

Dominium Vice President Mark Sween helped engineer a big savings by refinancing the mortgage at The Bluffs at Nine Mile Creek, at 7475 Flying Cloud Drive in Eden Prairie. (STAFF PHOTO: BILL KLOTZ)

Dominium has polished its local reputation recently with landmark projects like the conversion of the Schmidt Brewery in St. Paul and the Pillsbury A Mill into affordable apartments in Minneapolis.

But the Plymouth-based multifamily housing developer and investor also is busy outside Minnesota, expanding its portfolio in Sun Belt markets by picking up distressed properties.

In the last three years Dominium acquired 57 apartment communities with 8,304 units altogether. Sales of older, smaller properties in its portfolio offset some of that increase, but Dominium's total holdings still grew by 65.1 percent between 2008 and 2013 to 22,654 apartments.

Many of those properties came in bubble markets that plummeted during the recession. Texas and Florida are the company's second- and third-largest markets now; neither was in the portfolio five years ago.

Those new holdings are all Section 8 or low-income housing tax credit-financed apartments, which Dominium has specialized in for 40 years.

And they share another trait: They were all headaches for their previous owners.

"Most of what we've gotten involved in, we came in to fix problems," said Mark Sween, vice president for development at Dominium. "In most of these, occupancy was low, operating income fell short of what was needed, and invariably there were financing problems."

It may seem surprising that affordable housing had occupancy or cash flow problems during a recession. But Dan Smith, a Minneapolis-based U.S. Bank vice president who works in the affordable market, said that owners in the sector became giddy about easy debt just like their counterparts in the conventional world.

"Our industry wasn't immune to the loan structure mistakes that you saw in the conventional market at the peak of the last cycle," Smith said. "That meant a lot of good affordable projects got into trouble because they were carrying too much debt."

Properties also stumbled because their owners sought to ease the debt burden by deferring maintenance. The result? They lost tenants and cash flow to conventional properties that were newer and ready to slash rents to fill apartments, Smith said.

As those problems mounted, the large banks and other financial institutions that are primary investors in tax credits looked for a new general partner that could turn around the project and guarantee the long-term value of their investments.

Fixing up multifamily properties is meat and potatoes to Dominium, which has been operating affordable apartment communities for all its 40 years. The company was the eighth-largest owner of affordable housing at the beginning of 2012, according to Affordable Housing Magazine's annual survey.

In a turnaround, Dominium generally secures a share of the project by investing up to $1 million — out of its own cash or a bank loan — to repair buildings, cover negative cash flow, tighten up management, and rebuild occupancy levels. Dominium has also guaranteed the safety of the investors' tax credits.

A recent turnaround effort at the 76-unit Sea Mist project in Rockport, Texas, is typical.

Occupancy was in the low 80 percent range when Dominium formally took over in 2011. And Sea Mist had been registering negative cash flow of $50,000 to $100,000 annually. Dominium invested a little more than $300,000 in Sea Mist, installed new management and brought occupancy back up to the mid-90 percent range.

Sween said he hopes to see a payday during 2013 for Sea Mist in the form of a refinancing. Dominium and other affordable investors have been lining up to obtain mortgages from the U.S. Housing and Urban Development department or one of the government-sponsored enterprises (GSEs) like Fannie Mae that have remained near historically low rates for several years.

John Nolde, a Minneapolis attorney and specialist in affordable housing, said that although the wait is long for approval on those deals “there’s a huge volume.” A recent deal he advised obtained a HUD mortgage with a 2.09 percent interest rate for a 35-year fixed rate.

“At rates like that, troubled properties can get better. Anything can cash-flow at that rate,” Nolde said.

Sween says he hopes to refinance Sea Mist’s 8.8 percent mortgage this year down to about 3.5 percent.

Dominium has frequently tapped that HUD-GSE market. In 2012, the company refinanced 23 work-out apartment properties, lowering interest rates from an original range of 5.67 percent to 8.57 percent to a range of 2.09 percent to 3.79 percent.

Sween and his crew brought those savings to the rest of Dominium’s portfolio too, including a recent refinancing of the 188-unit Bluffs at Nine Mile Creek, at 7475 Flying Cloud Drive in Eden Prairie. The $26.8 million mortgage loan closed at a 2.7 percent interest rate.

Dominium has another 20 work-out and portfolio properties teed up for refinancing in 2013.

But there’s a cloud on the refinancing market, too. The heavy application volume for HUD and GSE mortgages and the agencies’ conservative underwriting mean affordable housing owners are waiting a long time for approval.

“If you can get a deal done in six months, that’s a shock,” Nolde said. “Twelve to 18 months is common.”

But 18 months is a long period to expect interest rates to continue.

“If a 2.6 percent rate went to 5, we underwrite so these deals will still work. They won’t work nearly as well, though,” Sween said.

Wider boundaries for Dominium

The affordable housing developer and operator increased its total apartment portfolio by more than 65 percent in five years, but that expansion occurred outside Minnesota.

Location: Current Properties / Units

Minnesota: 58 / 6,371

All states: 206 / 22,654

2008

Minnesota: 83 / 7,524

All states: 163 / 13,723

Source: Dominium

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