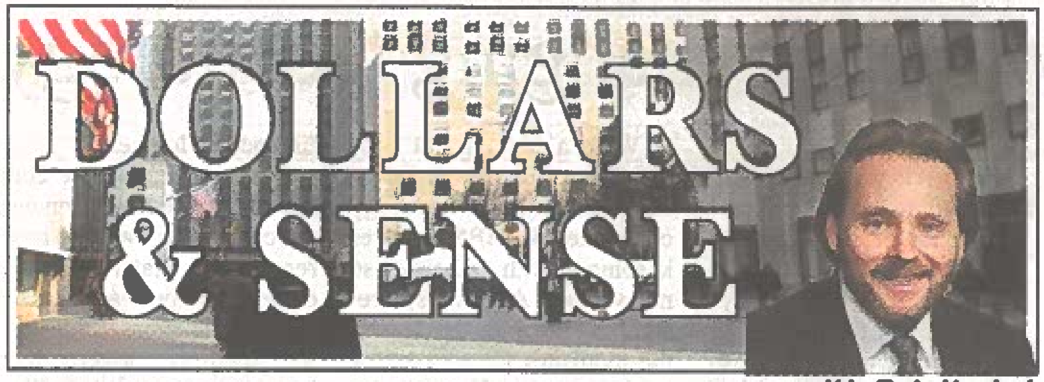

with Bob Knakal

Multifamily is a safe bet

Q. You frequently mention the strength of the multi-family sector. Is that due to rent regulation limiting the availability of apartments in New York or is there some other factor behind it?

A. The multi-family market in New York is always in the highest demand and you are correct that one of the main reasons is because of rent regulation.

From an investment perspective there are three reasons why the multi-family market here is so healthy.

First, rent regulation creates artificially low rents which creates inherit upside potential into these properties. Second, given the barriers to entry for new development, there is also a relative shortage within our housing stock leading to extraordinarily low vacancy rates, which today hover around 1 percent.

Third, because of the first two reasons, multi-family buildings are the most easily financeable product type given the relative certainty of cash flow, which banks are drawn to.

While these dynamics create a very strong multi-family sector in New York City, I think it is interesting to consider how multi-family housing will perform nationally. The recent trends have been very positive and it is understandable why many of our clients in New York are purchasing multi-family properties across the country.

We are currently at a point in time at which there is significant pent-up demand for household formation. The severity of the Great Recession has taken its toll on this economic metric.

The long-term average of annual household formations is about 1.2 million, to 1.3 million, households formed during a normal year. This is among the most challenging economic data to obtain, however, it appears that in 2010 there werr only 700,000 households formed and in 2011 about 850,000 households formed.

This is due to economic conditions which forced more families to "double up" and prohibited recent college graduates from moving out of mom and dad's house.

Additionally, significantly less immigration has occurred given the present administration's perspective on that issue.

With such below trend household formation, there is significant pent-up demand for these households to be formed.

As conditions permit, much of this demand will primarily result in rental households versus homeowner households. This clearly bodes well for the future of the multi-family market nationwide.

It is also interesting to consider the tremendous swings in the national homeownership rate. In the mid 1990's, about 64 percent of Americans owned their own home.

Through government trying to increase the homeownership rate, believing that it was in the country's best interest, (which was a major contributor to the housing bubble as government incentivized Fannie Mae and Freddie Mac to stimulate the housing market), and the home ownership rate was maxed out in 2005 at about 69 percent.

Today, the home ownership rate has recently dropped to about 66 percent based upon the massive number of foreclosures that have driven people out of homes and into rental properties, mainly multi-family buildings.

It is expected that the homeownership rate will continue to drop to an equilibrium rate of about 64 percent once again.

This is due to two factors. First, the foreclosure rate will continue to displace home owners and put them into the pool of renters, lowering the homeownership rate and increasing demand for rental units.

Second, American's perspective on home ownership, in general, is changing due to the tremendous upheaval the housing market is experiencing.

Once upon a time, Americans believed that owning a home was a safe investment and a method of creating a nest-egg for retirement.

It was thought that home values would never go down. This theory has vaporized. Today, fewer people believe that they must own a home in order to create wealth, thereby increasing demand for multi-family rental units.

Add to this the fact that when the government finally gets around to reforming Fannie Mae and Freddie Mac, whether it is done through privatizing these entities, creating public-private partnerships or breaking them into smaller entities, underwriting standards will certainly be more restrictive, thereby driving people into the rental market involuntarily.

For these reasons, we believe that the strength of the multi-family sector both locally and nationally will continue to be a safe bet for real estate investors for the foreseeable future.