CONCRETE THOUGHTS

# Investors ♥ NYC Apartment Buildings

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**But how long will the affair last? Legislative and judicial hurdles abound.**

New York City's multifamily property sales market continues to perform better than any other market segment, and with good reason. In addition to there being more apartment buildings than any other type of property in the city, demand from buyers in the marketplace for multifamily assets exceeds demand for any other property type by both number of investors looking to purchase and the amount of equity backing those numerous buyers. In the first three quarters of this year, 1,011 apartment buildings have been sold, with an aggregate market value of approximately $7 billion. These figures are up sharply from the 418 trades for $1.2 billion back in 2009.

This year, cap rates on elevator buildings across all submarkets have averaged 5.28 percent, and 6.34 percent for walk-ups. These yields are highly correlated to lending rates, and those rates have been at historic lows. The lowest cap rates are in Manhattan at 4.11 percent and 4.98 percent, respectively, and are highest in the Bronx at 6.58 percent and 8.32 percent, respectively. These are the lowest averages among all property types.

Multifamily properties in New York have

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several characteristics that put them at the top of the list for many investors. First, they are the easiest type of property to finance, as lenders battle each other to make loans on multifamily properties here. Lenders crave these loans due to the historically low vacancy rate on New York City apartments, typically in the 1 to 2 percent range. Couple this extraordinarily low vacancy rate along with the fact that New York's rent regulation system creates artificially low rent levels, and there is little perceived downside risk to these properties. Increasingly, however, the legislative and judicial environment is creating headwinds for the multifamily sector, which, if current trends continue, will lead to less affordable housing in the city (remember that rent regulation is not an affordable housing program), a deterioration of the quality of the existing housing stock and the virtual elimination of quality rental housing in the city.

From a legislative and judicial perspective, we are in, and seem to be getting deeper into, a period of great uncertainty. Recent court decisions, like the Roberts case, in which the deregulation of regulated apartments in buildings receiving J-51 benefits was deemed illegal, have created turmoil for owners of units in this category.

Another perplexing decision was the verdict in the Grimm case, under which the look-back period for owners' liability was extended beyond four years. This has created the need for buyers to conduct massive amounts of due diligence, because the exposure for overcharges travels with the title of the property, so a new owner becomes immediately liable for all past misdeeds of the prior owner(s).

Based upon the results of the recent election, it is still unclear who will control the New York Senate, which has a huge impact on the rent-regulated housing market. The Republicans do not have a majority, but there is an independent group of four Senate Democrats whose support is, presumably, up to the highest bidder. Many of the tangible shifts toward tenants occurred the last time the Senate was controlled by Democrats, and many in the industry fear the same thing may happen again.

Lastly, and almost more importantly for this market than the federal election, a big question is who the next mayor of New York City will be. Reading the bios, websites and press clippings of those who have already thrown their hats in the ring, there seems to be an overwhelming sentiment for a moratorium on rent-regulated rent increases, for repealing the Urstadt Law (which would turn oversight of rent regulation to the City Council) and for the elimination of high-income and high-rent deregulation. These initiatives would have disastrous impacts on our housing market.

Investors certainly love apartment buildings here, but how long will this seemingly insatiable appetite last? These looming clouds create a potential minefield for investors who are looking at this asset class.

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