The Surprising New 'Hot' Neighborhoods

North of 96th Street, market sees explosive gains, inspiring optimism

EXECUTIVE SUMMARY

- Harlem, Washington Heights, and Inwood combined boast more than $116,000,000 in first-quarter sales.
- With stabilized rents and low vacancy, it is likely that the upward trend will continue for the foreseeable future.
- Institutional investors have done significant work to improve assets and enhance the northern Manhattan submarket.
- Nearby blocks will benefit from Columbia's planned expansion, which has attracted investors to the neighborhood.
- Reduced crime rates and renovated buildings make northern Manhattan a newly viable option to tenants who would not have considered it in the past.

One of the questions I am most frequently asked is, "What neighborhoods are hot right now?" Coming off the lows of 2009, we have seen Manhattan generally leading the way out of the dearth of activity. The boroughs are still seeing decreased activity, but the reductions in transaction activity there are slowing down, indicating that the entire citywide market is likely to be in recovery mode by the end of this year. We are not surprised to see Manhattan leading the way out of the down cycle, as this has historically been the case. What is surprising is that northern Manhattan (north of 96th Street on the East Side and 110th Street on the West Side) has seen explosive activity gains and is actually outperforming Manhattan on a percentage basis.

Robert Knakal
Columnist

To explain the dynamics of the northern Manhattan building sales market, I have relied upon Massey Knakal's first vice president of sales, Rob Shapiro, who contributed significantly to this column.

A wave of optimism has begun to spread over the New York City real estate investment property sales market as transactional activity has been getting steadily healthier. In Manhattan, we have seen quarter-over-quarter increases in the number of sales for five consecutive quarters. Rob reports, however, that on a relative basis, nowhere is this optimism and upswing in activity more prevalent than in northern Manhattan (East and West Harlem, Washington Heights and Inwood). With more than $116,000,000 in sales volume, spread over 35 transactions, in the first quarter of 2010, it is clear that northern Manhattan is experiencing the sharpest rebounds in building sales activity.

Rental rates have stabilized, demand is strong and vacancy rates are low, and there have been hundreds of million of dollars invested in the local building stock over the past several years. With these strong fundamentals in place, it is likely that the upward trend will continue and is sustainable into the foreseeable future. These neighborhood-specific attributes have led to a 197 percent increase in aggregate sales dollar volume from Q1 2009 to Q1 2010.

Granted, that increase is in comparison to all-time lows and remains down 80 percent from its peak in Q1 2006; however, no other submarket in New York City has seen an increase anywhere close to that level. It is clear that investors are choosing to deploy capital in northern Manhattan today because they can buy improved assets that possess significant upside.

Investors who are entering the northern Manhattan market today benefit from significant work done by institutional investors to improve assets and enhance the many different neighborhoods making up this submarket. The overwhelming percentage of assets purchases uptown, from 2002 through 2007, were made by institutional investors. The investment strategy was to acquire individual properties and large portfolios of rent-regulated multifamily assets, make major capital improvements (MCIs) and increase revenues through efficiencies.

Many of the assets purchased during this period were in extreme disrepair, and living conditions for the tenants were extremely poor. In many cases, illegal tenants were occupying rent-regulated apartments. Non-primary tenancies and illegal sublets impact many of northern Manhattan's apartment buildings. Additionally, in many northern Manhattan neighborhoods, there are large three- and four-bedroom apartments that are operated as mini-hotels buy the tenant whose name appears on the lease. Upon inspection of these units, it is common to see padlocks on two or three of the bedrooms, indicating that these rooms are illegally rented to subtenants.

Many buildings riddled with drugs, prostitution and graffiti were about to get new owners, as these institutional investors became more attracted to the area: These investors, armed with extremely deep pockets, quickly began renovating and upgrading individual units and common areas and hallways. They installed security cameras and brought in security teams, consisting primarily of former N.Y.C. police detectives, to help restore order to their new assets. New roofs were installed and boilers were replaced, in some cases for the first time in more than 50 years. These improvements made the buildings more appealing for higher-paying market-rate tenants, as well as for those who continue to live there under rent regulation.

Neighborhoods citywide, and particularly in northern Manhattan, began to see drops in criminal activity not experienced in decades. Tenants who had previously not considered northern Manhattan a viable option were beginning to reconsider. Renters now view northern Manhattan as an opportunity to live in newly renovated buildings and apartments, in increasingly safer neighborhoods, at affordable prices. Because of the large-scale basis upon which these actions were implemented, improvements to overall quality of life skyrocketed.

The overwhelming majority of investment properties in northern Manhattan are residential, rent-regulated, walk-up and elevator apartment buildings. In fact, a resounding 88 percent of the investment stock is strictly multifamily. Retail, mixed-use and development properties represent the remaining 12 percent. Citywide, the multifamily asset class has weathered the storm the best, but the uptown market, in particular, has proved to be the most resilient.

The reason these northern Manhattan assets have remained so desirable is that the overwhelming majority of these buildings still fall under rent regulation. The rent-regulated status creates a large percentage of a building's revenue stream, stemming from artificially low regulated rents. The attractiveness of these below-market rents lies in their unique ability to insulate investors from the cyclical nature of market conditions. It also provides an ability to more accurately forecast and maintain a growing revenue stream. Investors are very attracted to these properties with low rents and the resulting upside potential created by them. The lower the rents, the more insulation offered, and the more appealing the asset becomes to the investment community.

Rob presents the following example to illustrate this dynamic: "Take a typical apartment building with 50 residential units, all one-bedrooms with an average rent of $800 per month. If these apartments were not rent-regulated, the market could bare as much as $1,400 for each of these units. In this recent downturn, market rents have decreased approximately 20 percent. So, in our example, that $1,400 one-bedroom apartment could now achieve only about $1,100. This market condition would have no impact on an owner's ability to rent apartments at the $800 level."

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In fact, while many owners with deregulated units across the city witnessed their revenues drop substantially, many rent-stabilized owners were able to increase their rent rolls. Even during this current economic recovery, where local and national unemployment rates hover around 10 percent, the vacancy rate in many rent-regulated assets remain extremely low or even nonexistent. Realistically, if one of those tenants paying $800 a month left tomorrow, not only could you replace them quickly, but you could also do so at a significantly higher rent.

Geographically, northern Manhattan benefits from superior accessibility to public transportation. Rob says that the area rivals the most serviced neighborhoods in Manhattan in terms of accessibility and diversity of transportation options. The high level of public-transportation options, including numerous subway lines, Metro North, local and express bus lines, a Port Authority bus terminal, the George Washington Bridge and numerous bridges into the Bronx, creates a strong draw for investors seeking these fundamentals. Properties close to public transportation directly benefit in terms of the level of market rents that can be achieved, vacancy rates and future sales values.

Furthermore, Columbia's planned expansion is well under way on the West Side up to 135th Street. The expansion of the campus significantly narrows the gap between the Columbia Presbyterian Medical Center on 168th Street and the current university boundaries. These blocks that are sandwiched in between stand to benefit from the cross-pollination these facilities will inevitably bring. The East River Plaza on 116th Street has brought new big-box retail tenants to an underserviced market. Work has also recently begun on the East Harlem Media and Cultural Center located on 125th and Third Avenue. The center is expected to be completed in 2017 and will encompass more than 1.7 million square feet of residential, commercial and community space. Investments in projects like these draw investors to the surrounding neighborhoods. In many neighborhoods of northern Manhattan, projects are in the planning phase, are under way or are nearing completion.

These dynamics provide insight into why Rob Shapiro, and our entire northern Manhattan team, is so bullish on the area. Thus far in 2010, northern Manhattan has proven to be one of the strongest investment sales markets in New York City. High-net-worth individuals and institutional investors are attracted to the strong fundamentals these buildings offer. Additionally, they are selecting uptown to deploy capital because the neighborhoods and assets have been significantly revitalized from massive capital investment over the past several years. Due to all these factors, it is not surprising to see the tremendous demand that investors have demonstrated for investment properties in northern Manhattan today.

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