



with Bob Knakal

Walk-ups versus elevator properties

Q: The historical reports from Massey Knakal regarding the multi-family market always indicate that capitalization rates on elevator buildings are lower than those for walk-ups.

However, your recent reports show that the selling price per square foot is higher for walk-ups than for elevator properties. How can this be the case?

A: This is a great question as, on face value, the dynamic you

mention does indeed seem to be counterintuitive.

We have studied the multi-family sector in Manhattan since 1984 and in 21 of these 26 years, cap rates on elevator buildings have been lower than cap rates on walk-ups.

The last time the average walk-up cap rate was lower was in 2004 and, since then, elevator caps have averaged 101 basis points lower than walk-ups.

Even with this gap in cap rates, we have seen the average sales price per square foot of walk-up buildings surpass the value per square foot observed in the elevator sector.

There are two factors which make this counterintuitive dynamic a reality.

The first is that tenancy turnover in walk-ups greatly exceeds tenancy turnover in elevator buildings. Generally, tenants do not aspire to live their entire lives in walk-up buildings. Many college graduates and first time New Yorkers rent in walk-ups, using these units as stepping-stones to other accommodations.

For this reason, owners of walk-ups are more easily able to tap into the upside potential embedded in New York's multi-family properties by virtue of our rent regulation system. As tenants relocate, owners can essentially move rents to market levels.

The second factor is that unit sizes in walk-ups tend to be smaller than comparable room count units in elevator properties. For instance, a one-bedroom apartment in a walk-up might be 350 square foot while a one-bedroom in an elevator building might be 700 square feet.

Even though the monthly rent check the tenant writes in the elevator building will be a larger amount, the rent in the walk-up is higher on a per square foot basis. This higher rent leads to a higher building value on a price per square foot basis for walk-ups.

We first started to see this dynamic in 2009 and it is not just a Manhattan phenomenon.

In fact, in 2009, building sales value per square foot in the walk-up sector exceeded elevator value in all boroughs. This dynamic has continued in the first half of 2010 and we expect that this will be the case in the foreseeable future.

Knakal is the chairman and founding partner of Massey Knakal Realty Services and has brokered the sale of over 1,075 properties in his career having a market value in excess of \$6.5 billion.