Dollar Volume Is Up for Apartment Buildings

The multifamily market gets a boost as rents increase and better quality properties sell, but each submarket behaves differently

The multifamily apartment building market has always been a leading indicator for the investment sales market in New York City. Rent-regulated apartment buildings here have been the asset class most highly demanded by investors and have always been the property type for which financing has been plentiful—and plentiful from multiple sources. The upside potential of these properties, based upon artificially low rent levels created by rent regulation, creates a scenario in which there is almost no downside risk. Even throughout our most recent recession, in which market rents fell by 20 to 25 percent, most regulated buildings continued to see net operating income increase as regulated rentals turned over and rose.

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Rent regulations were recently renewed but, unfortunately, the uncertainty created by the Roberts decision in the StuyTown case was not resolved. This decision places many apartments in buildings receiving J-51 tax benefits in limbo as the decision created more questions than answers about the legal status of deregulated units in these buildings. While this uncertainty has negatively impacted the market, apartment buildings continue to be highly sought after and the sales activity in this product type has been fascinating to observe. This week we will examine what we are seeing in this market segment.

The activity in New York City's multifamily market has been illustrative of some interesting trends of late. If we annualize the citywide activity in the sector through August 2011, we see that the number of apartment buildings sold is essentially flat from 2010. This year we are on pace for 552 multifamily property sales, compared with 545 last year. The number of units sold is also about the same, year over year, as we are on pace for about 15,200 units to be sold this year versus 15,500 units sold in 2010. In 2009, this figure was just 10,500 (see the charts nearby for more details).

Interestingly, however, while the number of sales is essentially flat, the dollar volume is projected to be up significantly as we are on pace for approximately $3.8 billion of multifamily transactions versus only about $2.5 billion last year. In 2009, this figure was $1.3 billion. This trend shows that larger, and more well located, assets are selling relative to last year. If we look at the value of these transactions, we see that thus far in 2011, the average price per square foot for a multifamily building was $232, up 6 percent from the $218 average in 2010. While this is a modest increase, it does show that value is rising.

Moreover, it is interesting to note that the average price per unit sold has increased by 23 percent, from $154,000 in 2010 to $190,000 this year. This is indicative of the fact that rents are increasing and that better quality properties are selling.

With regard to cap rates, we have seen a 23-basis-point drop from the 2010 average of 6.85 percent, down to 6.62 percent. Counterintuitively, the average gross rent multiple (G.R.M.) has remained relatively unchanged, dropping only two basis points, from 9.39 to 9.37. Typically, when capitalization rates drop, the average G.R.M. should increase. We believe that the reason that this dynamic exists is due to rising rent levels while expenses are rising faster than revenue is increasing. A huge influence on this dynamic is the incomprehensible fact that real estate taxes have continued to rise, and rise significantly, during a period during which we saw values fall 38 percent on average, on a price-per-square-foot basis, from peak to trough.

Within the multifamily marketplace there are two distinct asset classes in New York. They consist of walk-up buildings versus properties with elevators. While this difference is not meaningful in much of the rest of the country, it is very significant in New York City. As such, we track both of these product types separately, as if they were different asset classes.

If we look at the performance of walk-up buildings citywide, we see that the number of buildings sold thus far in 2011 is on pace to be 4 percent higher than last year's total. We expect 430 properties to trade this year versus the 415 sold in 2010. The percentage increase in the number of units sold mirrors the number of buildings sold as we are presently on pace for approximately 6,300 units sold in the walk-up sector this year versus 6,100 last year, a 3.3 percent increase.

The dollar volume of sales within this sector is up 12 percent over the $827 million in walk-up sales last year, as we are on pace for $926 million in 2011.

Volume is relatively easy to interpret; however, value leaves us scratching our heads a bit. Cap rates in the walk-up sector have dropped about 21 basis points from an average of 7.07 percent in 2010 to 6.86 percent this year. With cap rates dropping, one would expect G.R.M.'s to increase. Mysteriously, the average G.R.M. is down about one-half of one multiple, from 9.42 in 2010 to 8.89 thus far this year.

When we look at the elevator sector of the market, we see that the number of buildings sold in 2011 is on pace to be about 8 percent lower than the 131 properties sold citywide last year. Annualizing sales activity through August 2011 shows that we are on pace for 120 properties sold this year. Congruently, the number of apartment units sold also appears to be on pace for about a 9 percent reduction, from 9,747 units sold last year to a pace of about 8,883 this year.

When we look at the dollar volume of these sales, there is a substantial increase anticipated, as there was about $1.8 billion of elevator buildings sold last year and we have already achieved nearly that amount in 2011. Annualizing year-to-date activity shows that we are on pace for about $3 billion of elevator building sales this year, a 62 percent increase.

What is most remarkable about the elevator segment is that we have seen a nearly 36 percent increase in the price-per-square-foot achieved. The 2010 average was $199 and, thus far in 2011, the average has been $270. This significant increase occurred with only a 30-basis-point reduction in the average cap rate. The 6.26 percent average achieved in 2010 has dropped to 5.96 percent citywide in 2011. This reduction in cap rates has been accompanied by an increase in the G.R.M. of 1.61, from 9.24 in 2010 to 10.85 this year. The increase in G.R.M. is of a much more significant magnitude than the decrease in cap rates, indicating, again, that we are seeing expenses rise in these properties alongside increases in rents.

The fact that the average price-per-unit paid has nearly doubled is also very telling. In 2010, the average price-per-unit paid citywide was $148,000. This year it is running at $273,000, an 85 percent increase. This again is indicative of the fact that larger, better located properties are trading and, most notably, the condo conversion mechanism is sifting back into the marketplace. This trend cannot be overstated as it represents a seismic shift in investor perspective.

To obtain a truly insightful perspective on New York City's multifamily market, it is critical to look at each submarket individually. We will examine each of these submarkets next week to see how different markets are performing. We will see that different segments are operating independently and that trying to connect the dots, submarket to submarket, may be more difficult than one would expect.

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ELEVATOR - MULTIFAMILY

Period Year		# Buildings	Dollar Volume	Average Price	Average Price Per Bldg SF	Units	Average Price Per Unit	Average Cap Rate	Average GRM
2011	Annualized	120	$ 2,929,971,291	$ 24,416,427	$ 270	8,883	$ 273,002	5.96%	10.85
2011	YTD	70	$ 1,709,149,920	$ 24,416,427	$ 270	5,182	$ 273,002	5.96%	10.85
% diff 10-11 annualized		-8%	62%	77%	36%	-8%	85%	-30 bps	1.61
2010	YEAR END	131	$ 1,804,740,842	$ 13,776,648	$ 199	9,747	$ 147,774	6.26%	9.24
2009	YEAR END	95	$ 642,237,690	$ 6,760,397	$ 159	4,972	$ 157,821	6.22%	8.99

Source: Massey Knakal Realty Services

WALK UP - MULTIFAMILY

Period Year		# Buildings	Dollar Volume	Average Price	Average Price Per Bldg SF	Units	Average Price Per Unit	Average Cap Rate	Average GRM
2011	Annualized	430	$ 926,162,511	$ 2,152,436	$ 224	6,303	$ 179,316	6.86%	8.89
2011	YTD	251	$ 540,281,485	$ 2,152,436	$ 224	3,677	$ 179,316	6.86%	8.89
% diff 10-11 annualized		4%	12%	8%	-2%	3%	8%	-21 bps	-0.52
2010	YEAR END	415	$ 827,040,276	$ 1,992,868	$ 229	6,102	$ 166,175	7.07%	9.42
2009	YEAR END	372	$ 697,791,719	$ 1,875,784	$ 223	5,532	$ 170,342	6.65%	9.72

Source: Massey Knakal Realty Services

MULTIFAMILY COMBINED (Elevator and Walk-up Properties)

Period Year		# Buildings	Dollar Volume	Average Price	Average Price Per Bldg SF	Units	Average Price Per Unit	Average Cap Rate	Average GRM
2011	Annualized	550	$ 3,856,133,803	$ 7,007,512	$ 232	15,187	$ 190,720	6.62%	9.39
2011	YTD	321	$ 2,249,411,385	$ 7,007,512	$ 232	8,859	$ 190,720	6.62%	9.39
% diff 10-11 annualized		1%	47%	45%	6%	-4%	21%	-23 bps	0.02
2010	YEAR END	546	$ 2,631,781,118	$ 4,820,112	$ 218	15,849	$ 162,322	6.85%	9.37
2009	YEAR END	487	$ 1,340,029,409	$ 2,899,442	$ 209	10,504	$ 167,352	6.52%	9.50

Source: Massey Knakal Realty Services