LOFTS GROW SMALLER
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FACT
The city has sold more than 8,000 properties since 1996.
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The Real Deal/Hugh Hartshorne

Robert Knakal (l.) and Paul Massey Jr. of Massey Knakal Realty Services, which specializes in small building sales.

Walk-ups step up

Prices shoot up, even as rents decline; still a good buy

Carl Unegbu

SPECIAL REPORT

A rising tide may be lifting all the boats bobbing atop the New York real estate market, but some investors are finding potential rewards in a market niche where it's better to climb the stairs than float on market currents.

In the real estate downturn that followed the 1987 stock market crash, the city's 40,000 walk-up apartment buildings lost about 75 percent of their value as lenders initiated a spate of foreclosures and ended an era of easy credit.

Brokers say prices for walk-ups are now reaching levels they would never have believed a decade ago, which makes them attractive to investors seeking diversification in a weak stock market. With the benchmark S&P 500 stock index up only about 1.5 percent for the year to date, some brokers say owning a walk-up apartment or a small building may be a good investment hedge. This is despite potentially onerous regulations that make many walk-up apartments subject to rent controls or stabilized rental rates.

While they may not offer the highest rental rolls in the city, walk-ups constitute about 25 percent of New York's housing stock, and are now getting a good long look from investors.

"They are the most conservative, I think, best real estate investment in the city," said Georgia Malone, president of Georgia Malone & Co, Inc., a commercial brokerage that sees a significant percentage of walk-up apartment sales.

Malone sees walk-ups, most of which are rent stabilized, as low-risk investments with high upside potential. She says there is substantial potential for rent appreciation as low-rent tenants move on and landlords increase rents. In a rental market where walk-ups now have a 95 percent occupancy rate, the demand supports the proposition, she says.

Bob Knakal, chairman of Massey Knakal Realty Services, which specializes in small building sales, says some buildings have increased their value tenfold in a decade.

"The overall prices are astounding," he says. "The same buildings

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Broker Survey Says:

Poll finds new agent influx worst trend, tech best

Stuart W. Elliott

SURVEY

For David Goldsmith, a broker at DG Neary Realty in Chelsea, a sign that the ranks of Manhattan's real estate agents are swelling with inexperienced newcomers is the number of phone calls the 20-year veteran calls silly and redundant.

"I get more calls from untrained new agents where every question they ask is already on the web site," Goldsmith said. "Or they call on a six-unit building in Soho and ask if there is a doorman."

As part of an in-depth survey of Manhattan residential real estate agents this month, *The Real Deal* found that nearly 50 percent of brokers interviewed said the number of new agents - which creates more competition for business - was the most significant negative trend in the industry in the last five years.

The survey, which drew responses from about 45 brokers, nearly all of whom are in senior positions, found that the number one positive trend over the last five years has been - perhaps unsurprisingly - technology and listings systems for brokers.

"What might take a buyer a couple of hours on the web to search can take a few minutes for us," said John Sheets, a director at BrownHarris Stevens.

In the seven-question survey, agents were also asked about the perceived real estate bubble. Ninety-five percent of agents said there wasn't one, but gave different reasons.

"I don't think it's a bubble, but I don't think it can go much higher," said Marillyn Abrams, a senior vice president at Douglas Elliman.

Interviews also weighed in on new developments -- with a near majority noting that finishes were the number one improvement in the last few years.

Many had more specific answers.

"The overtaxing of new conversions is a negative trend. You could have 80 cents per square foot being just your taxes," said Steven Ganz, a vice president at Douglas Elliman. "Taxes are maybe 40 percent higher than five years ago."

The survey results follow, starting on page 16.

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German investors: über-building buyers

Will Swarts

If Manhattan's commercial market has only one word for some of its biggest buyers, then lately, that's been "Wilkommen."

A favorable exchange rate, looser domestic investment regulations and years of low interest rates mean German investment funds, most backed by money from individual investors, have become major property buyers in New York, amassing a 16-million-square-foot portfolio that includes both Class A Midtown trophy space and, increasingly, purchases in other areas of Manhattan, including condominiums, Class B office space and Downtown properties.

While the peak purchasing period has probably passed, industry observers say the shift beyond the blue-chip properties of the past reflects a changing market on both sides of the Atlantic, and those shifts account for a more than 200 percent increase in total German investment here since 2001.

According to commercial market tracking firm Real Capital Analytics, German investors pumped $780 mil-

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German investment in real estate

NYC
2001: $780 million
2004: $2.5 billion*
U.S.
2004: $3.5 billion*

Source: Real Capital Analytics
*year to date

At a Glance

Apt. market: focus on fall

August is typically one of the quietest months of the year for apartment sales, and brokers said this August was not markedly different from years past.

Much of brokers' focus is on what will happen in late September and October when things will start gearing up again.

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In Fort Greene, boom after bust

For more than a century, Fort Greene, a neighborhood of landmark buildings like the Brooklyn Academy of Music and majestic brownstone and brick town homes, has seen boom and bust. But the latest trend toward gentrification appears poised to stay for a while, and much new development is in the works in the neighborhood.

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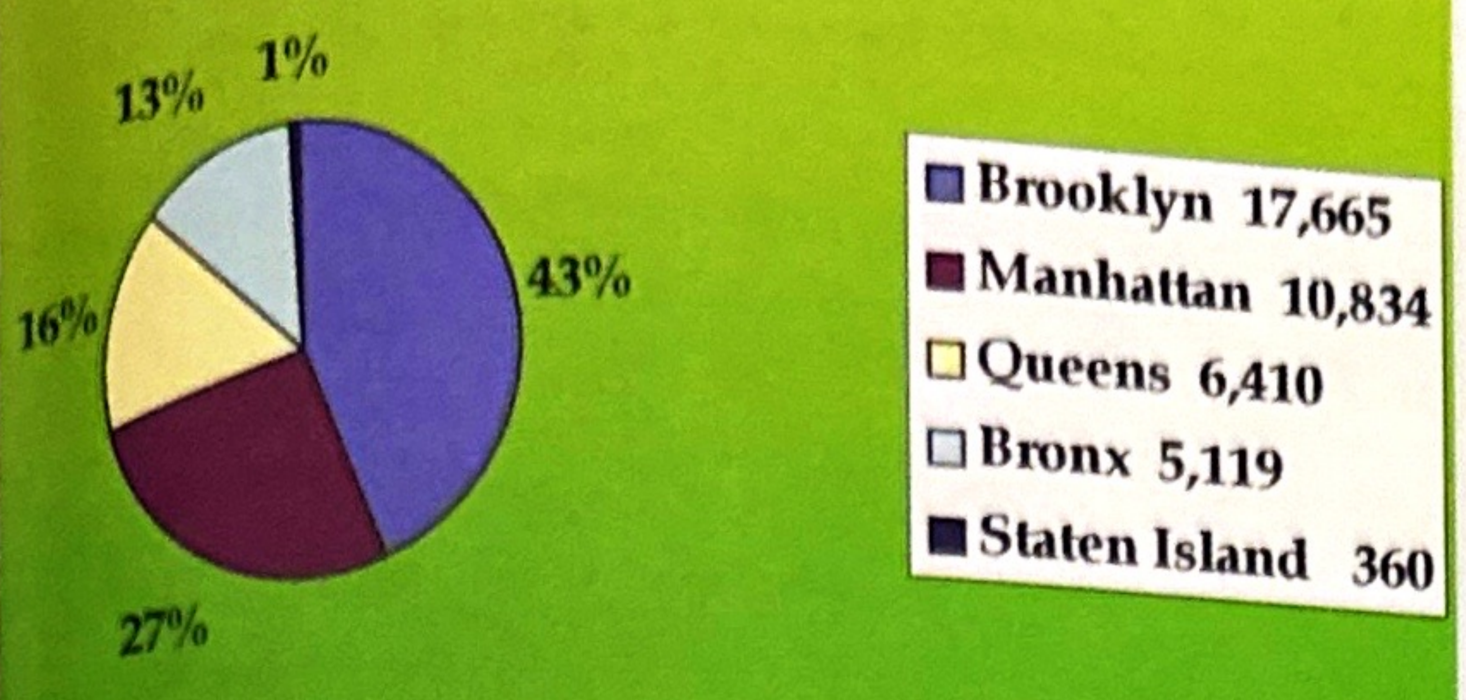
Inside

Walk-up buildings in NYC



Typical 10-unit walk-up
Price: $2.1 million
(source: Massey Knakal)

Average rent for one-bedroom apt. in walk-up building:
Today: $1,500
1970s: $150
(source: Manhattan Apartments Inc.)

Rent multiple
[excess of purchase price over rent roll]:
Risen 5-12 times over last decade
(source: Georgia Malone & Co, Inc.)

Average cap rate
[net income divided by purchase price]:
Today: 4%
A decade ago: 10%
(source: Georgia Malone & Co, Inc.)

Rents decline for walk-ups

Continued from cover

that sold for $300,000 in 1994 may be selling for $3 million today."

He calls the newfound allure of these buildings a surprise in the context of other market trends.

"What is striking here is that rents have been going down over the past two years while the prices of apartments have been increasing." He says a typical 10-unit walk-up in the five boroughs today would sell for about $2.1 million.

Rising rents have also prompted long-time investors to forego potential gains from market appreciation to sustain revenues from rising rent rolls, says Marc Lewis, vice president and managing director of Manhattan Apartments, Inc.

Lewis says monthly one-bedroom rents in walk-up buildings averaged $150 in the 1970s, when he began his career. The same units fetch $1,500 today.

"People can now retire on [the income from] one walk-up and many buildings bought five years ago are now worth double."

Over the past decade dropping cap rates – the net building income divided by purchase price — and rising rent multiples – the difference between the purchase price and the rent roll – paint a healthy picture for walk-ups.

While the cap rate has dropped from 10 percent to 4 or 5 percent over the past decade, the rent multiple has risen to between 5 to 12 times over the same period, Malone said.

Georgia Malone, who heads her own commercial brokerage firm.

It's a big change from two decades ago when walk-ups were being foreclosed upon, selling for 25 percent of their original purchase prices.

With strong economics, walk-ups are drawing a new class of owners. In addition to veteran property owners, new investors, mostly professionals from other walks of life, are buying single buildings, and make up as much as 20 percent of the market, according to Lewis. He says veteran owners make up about 50 percent of the market, and the rest of the market is user dealers (those who also live in their buildings) and bargain hunters who convert walk-ups to higher priced condos for sale, especially in emerging neighborhoods.

Institutional investors have taken a closer look as well, says Malone, who is working with Apartment Investment & Management Co. (AIMCO), a Denver-based real estate investment trust, which she says is on a shopping binge throughout the city. She says REITS are drawn to walk-ups because they are long-term investments with a strong upside that meets the buying parameters of these public companies.

But not everyone has been able to join the gold rush of the walk-up market, where extensive rent regulations create barriers to players unfamiliar with their workings. Malone says foreign investors have mostly stayed away from the unfamiliar walk-up market with its thicket of regulations, which could expose the unwary to booby traps of stiff fines and penalties for violations. They prefer the safety of office buildings and elevator residential properties.

Also, not every walk-up building is going to be part of the bonanza, because many are being torn down and rebuilt as elevator buildings, especially along the avenues of Manhattan, where zoning laws allow high-rise residential properties.

"On the avenues, you can go up to 30 stories and people can buy three or four walk-ups in a row [which are about 25 feet wide] and build them into more modern apartment buildings," says Malone. The profits from larger condos and co-ops are causing the stock of walk-up buildings to "diminish greatly," she says.

Low interest rates and easy credit have made larger development an easier option for investors able to come up with the initial capital, according to Malone.

But previously neglected neighborhoods, such as East Harlem in Manhattan and Bedford-Stuyvesant and Williamsburg in Brooklyn are still being mined for walk-up opportunities, says Joel Radmin, president of Extreme Realty, LLC.

"Rehabilitation of brownstones is the only inventory that is growing in walk-ups," he says.

Broker-investors few in number

No more bargain prices for walk-ups; some site conflict of interest

Carl Unegbu

Walk-up apartments make up 25 to 30 percent of the city's residential housing stock, and new investors are trying to cash in on the tricky, but potentially lucrative segment of the market.

Still, real estate brokers – among the best informed members of the pool of potential buyers – aren't joining the ranks of new building owners in any sizable numbers, because the market is so hot. Maybe too hot.

"It's just a small percentage because the prices have gotten so high," says Marc Lewis of Manhattan Apartments Inc. "The average broker doesn't have $5 million to buy property."

Bargains are so thin on the ground they are almost nonexistent, he says. The lower prices from a building's first sale are largely gone since most walk-ups have already been sold two or more times.

In addition to prices, probity is also an issue. Bob Knakal of Massey Knakal Realty thinks it's a bad idea for brokers to be buying these properties, citing potential problems down the line. "I don't think it's a good policy," Knakal says. "I think it's a conflict of interest and it's something that our firm doesn't do."

Knakal says a broker with a reputation for buying properties would make potential buyers wonder why he's not buying the property he's selling. Other brokers don't see a conflict of interest, especially if the listing isn't exclusive. They says problems are avoided if the broker fully discloses his interest to the seller.

"Why should real estate brokers not have the same benefit as everybody else?" said Eric Roth of Friedman-Roth Realty. "If they disclose [their interest], then it's not a conflict of interest." He readily admits that exclusives are a different matter. "Of course, it's different where someone is listing property with a broker as an exclusive."

Joel Radmin of Extreme Realty says Knakal's view stems from his firm's practice of dealing mostly with exclusives.

Georgia Malone, of commercial real estate brokerage Georgia Malone & Co., says brokers would be foolish to forego the upside of the current market. But she admits that conflict of interest is a real challenge.

Apart from full disclosure, Malone thinks a way out of the potential "quagmire" is for the broker to agree not to buy the property for himself if it isn't sold. This way, Malone says the broker will exert his best efforts to represent the seller and still collect his commission.

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