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Northern Manhattan –Leading The Way Towards Recovery

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A sense of optimism has begun to return to the New York City real estate investment property market as transactional activity has been steadily rising quarter by quarter. Although this overall trend is being felt in neighborhoods all over the city, nowhere is this more prevalent than in Northern Manhattan (East & West Harlem, Washington Heights and Inwood). With over $116,000,000 in sales consisting of 35 transactions in the first quarter of 2010, it is clear that Northern Manhattan is experiencing one of the sharpest rebounds in activity.

With strong fundamentals in place, it is likely that the upward trend is sustainable for the foreseeable future. These neighborhood specific attributes have led to a 197% increase in aggregate sales dollar volume from Q1 2009 to Q1 2010. Granted, that increase is in comparison to all time lows and is still down 80% from its highs in Q1 2006. However, no other market in New York City has seen an increase anywhere close to those levels. It is clear that investors are choosing to deploy capital in Northern Manhattan today because they can buy improved assets that still possess significant upside.

Picking up the Pieces

Investors who are entering the market today benefit from all the work done on an institutional basis to improve the assets and neighborhood. The overwhelming percentage of assets purchased uptown from 2002 through 2007 were made by institutional investors. The investment strategy was to acquire large portfolios of rent regulated multifamily assets, make Major Capital Improvements (MCI's) 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 many illegal tenants were occupying rent regulated apartments. Buildings riddled with drugs, prostitution, and graffiti were about to get new landlords. These landlords, armed with extremely deep pockets, quickly began cleaning and upgrading. They installed security cameras and brought in security teams comprising many former NYC police detectives to help restore their new assets. Any tenant performing illegal activities and any non primary tenants, (tenants who do not have the legal right to occupy apartments), were dealt with accordingly. New roofs were installed and boilers were replaced, in some cases for the first time in over 50 years. Renovations to the common spaces and hallways were also made. These improvements made the buildings more appealing for higher paying market rate tenants as well as those who continue to live there under rent regulation.

Neighborhoods 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 viewed 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 in which these actions were conducted improvements to overall quality of life skyrocketed. Changes this substantial, which might have taken decades to achieve, were attained in about five years.

Asset Class and Upside

The overwhelming majority of investment property in Northern Manhattan is residential, rent regulated, walk-up and elevator apartment buildings. In fact a resounding 88% of the investment stock is strictly multifamily. Retail, mixed-use and, development properties fill in the remaining 12%. City-wide the multifamily asset class has weathered the storm the best, but the uptown market in particular proved to be the most resilient. The reason these assets in this neighborhood have proven to remain so desirable is that almost all of these buildings still fall under rent regulation. The rent regulated status translates to a large percentage of a buildings revenue stream to flow from significantly below market rents. The attractiveness of these below market rents lies in their unique ability to insulate the investor from sudden "blips" in the 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 upside potential. The lower the rents, the more insulation it offers and the more appealing the asset becomes.

For example, take a typical apartment building with 50 residential units (apartments), 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 $1400 for each of these units. In this recent downturn, market rents have typically decreased approximately 20%. So in our example that $1400 one-bedroom apartment could now only achieve approximately $1100. This decrease would have no effect of your ability to rent apartments at the $800 level. 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 the national unemployment rate is approximately 9.9% the vacancy rate in many rent regulated assets remain extremely low or even non existent. In fact, 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.

Availability of financing

The financing market remains strong for the multifamily market with below market rents. Lenders are still eagerly interested in providing financing for multifamily assets. Community banks are dominating the marketplace and are offering attractive rates. At the time of writing this article it is common for banks to use a 6.75% cap rate on a property's N.O.I to determine the appraised value. They have been aiming for a 1.25 – 1.30 debt service coverage ratio and offering five year fixed mortgages with 30 year amortization periods with interest rates in the mid to low 5%'s. Currently, there is a Fannie Mae product being offered with a substantially lower interest rate. However, they require very thorough trailing documentation that can prove to be cumbersome as sellers may not have or be willing to provide.

Geographic Superiority

Geographically, Northern Manhattan benefits from its superior accessibility to public transportation. It rivals the most serviced neighborhoods in Manhattan in accessibility and diversity of transportation options. Being serviced by numerous subway lines, the Metro-North Railroad, local and express bus lines, a Port Authority bus terminal, the George Washington Bridge and numerous bridges into the Bronx is a strong draw to investors. Having property close to public transportation is directly related to the value of rents that can be achieved, vacancy rates, and future sales values. Public transportation has helped define a neighborhood's desirability in New York City. In few areas on the island of Manhattan is it as abundant.

Continued Growth and Investment

Columbia's planned expansion to 135th Street is well under way on the west side. 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 cause. The East River Plaza on 116th Street has brought new big box retail to an underserviced market. Work has also recently begun on the East Harlem Media and Cultural Center located on 125th and Third Avenue. Expected completion is approximately 2017 and it will encompass over 1.7 million 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, underway or newly construction.

Northern Manhattan has proven to be one of the strongest investment sales markets in New York due to many investors realizing the upside potential that it possesses. They are attracted to the strong fundamentals it offers and they are selecting uptown to deploy capital because the neighborhoods and assets have been significantly revitalized from institutional investment. The area is densely serviced by almost every form of transportation and continues to draw new opportunities for large scale developments. Due to all these factors, investing in Northern Manhattan today is a smart, safe and desired play for investors.